TAX EXECUTIVES INSTITUTE, INC.

INCOME TAX QUESTIONS

Submitted to

CANADA REVENUE AGENCY

DECEMBER 3, 2013

Tax Executives Institute welcomes the opportunity to present the following comments and questions on income tax issues, which will be discussed with representatives of the Canada Revenue Agency (hereinafter "CRA" or "the Agency") during the December 3, 2013, liaison meeting. If you have any questions about the agenda in advance of the meeting, please do not hesitate to call Shiraz Nazerali, TEI's Vice President for Canadian Affairs, at 403.213.8125 or, Bonnie Dawe, Chair of the Institute's Canadian Income Tax Committee, at 604.331.4864.

1. Vision 2020

We invite CRA to provide an update on its *Vision 2020* initiative.

2. Risk-Based Audits

In response to question 12 in the 2012 liaison meeting agenda, CRA advised that it was too early to (1) draw conclusions with respect to the state of tax-risk governance and (2) share its findings and experiences on the risk-assessment process. Many large taxpayers have now completed the risk-assessment process and also experienced a post-risk-assessment audit. Taxpayer's anecdotal descriptions of their experience with both the risk-assessment process and the first post-risk-assessment audit have varied widely. Would CRA provide an update on its observations and summarize trends or conclusions for the initiative? Can CRA provide a summary of feedback from taxpayers and field auditors?

3. Forms, Publications, Electronic Services, e-Filing, & Miscellaneous, including Carryover Items from Prior Years

a. Form T5018. In response to question 8 in the 2012 liaison meeting agenda, CRA said that it would consider permitting a joint venture to report payments made to contractors for construction services on one Form T5018 (*Statement of Contract Payments)* slip rather than requiring each co-venturer to issue separate T5018s for their proportionate share of payments to the contractors. We invite CRA to advise whether these changes will be implemented and the expected timing for implementation.

b. Form T5013. In response to question 1(a) in the 2012 liaison meeting agenda, CRA said it is enhancing the electronic return filing system to permit Form T5013 (*Statement of Partnership Income*) to be filed electronically through the My Business Account (MyBA) portal. The target date for the enhancement to the electronic filing system was January 2014. We invite an update on the expected timing for the added functionality. In addition, please provide an update on the timing for adding the ability to review previously filed Form T5013s online.

Finally, CRA acknowledged in its response to question 13 in the 2012 liaison meeting agenda that Schedule 50 (*Partner's Ownership and Account Activity*) of Form T5013 should be modified. Subsequent to the meeting another potential issue about the current format was discovered. Specifically, columns 10 to 13 of Schedule 50 are added to calculate each partner's At-Risk Amount (ARA) at the end of the fiscal period in column 14 [50-440]. Presumably, columns 10 to 12 are equivalent to the additions to ARA adjustments described in paragraphs 96(2.2)(a) to (b.1) of the Income Tax Act (ITA). Column 12 [50-420] is labeled "Partner's share of the fiscal period's resource expenses" and presumably represents the addition to ARA described at paragraph 96(2.2)(b.1), but that paragraph requires the addition of the "amount referred to in subparagraph 53(1)(e)(viii)," which are the proceeds of disposition in respect of resource-related properties rather than a "Partner's share of the fiscal period's resource expenses." Moreover, the "Partner's share of the fiscal period's resource expenses" is already taken into account in the calculation of the adjusted cost base (ACB) (*i.e.*, as a reduction of the ACB of a partnership interest at subparagraph 53(2)(c)(ii)). Accordingly, there would be no need to deduct that amount from ARA a second time. Finally, column 12 on the Form is an addition rather than a subtraction, which is contrary to the ITA. Thus, the description of column 12 [50-420] is misleading or incorrect. Would CRA consider modifying Form T5013 to label Column 12 [50-420] as the "amount referred to in subparagraph 53(1)(e)(viii)" rather than "Partner's share of the fiscal period's resource expenses"? We invite CRA's response.

c. Electronic Filing of Foreign Reporting Forms. In response to question 1(b) in the 2012 liaison meeting agenda, CRA stated that the International Tax Data Working Group is reviewing enhancements to the filing system in order to permit certain foreign reporting forms to be filed electronically. In addition, the 2013 Federal Budget states that the government will modify the filing system to accommodate electronic filing of Form T1134 (*Information Return Relating to Controlled and Not-Controlled Foreign Affiliates*). We invite an update on this initiative, including the expected timing of when taxpayers will be able to file T1134s and T106s (*Information Return of Non-Arm's Length Transactions with Non-Residents*) electronically.

d. Exchange of electronic information. Has CRA made any progress in developing a mechanism for secure (two-way) exchange of electronic information and correspondence between taxpayers and CRA, especially

during audits? Many companies are digitizing records and moving to a paperless environment as much as possible. Interactions with CRA would be significantly enhanced, the flow and speed of the audit process would be improved, and a significant amount of wasted paper would be eliminated if taxpayers and CRA corresponded electronically. Such communication is available through the IronPort encryption internet application used by the Québec Ministry of Taxation (MRQ) and other similarly secure internet sites in other tax jurisdictions.[1]

e. Income Tax Folios. We invite CRA to provide an update on replacing the interpretation bulletins (ITs) and information circulars (ICs) with Income Tax Folios (*i.e.*, the Folios initiative).

In addition, CRA's stated policy with respect to the application of income tax interpretation bulletins was set forth in the Application section of the "IT - INDEX - Interpretation Bulletins and Technical News Index" and in the Application section of many Interpretation Bulletins.

The policy was, as follows:

> *An interpretation described in a bulletin applies as of the date the bulletin is published, unless otherwise specified. When there is a subsequent change in a previous interpretation or position, and the change is beneficial to taxpayers, it is usually effective for all future assessments and reassessments. However, if the change is not favourable to taxpayers, it is normally effective for the current and subsequent taxation years or for transactions entered into after the date of the bulletin.*

Will similar rules of application apply to Folios?

f. Form RC18 "Calculating Automobile Benefits for 2012." In Form RC18, the first amount entered is described as the "cost of automobile you provided (must be at least equal to the fair market value." Subsection 6(2) of the ITA, however, refers solely to "cost" and does not refer to fair market value. Hence, TEI questions why — when making the determination of a reasonable automobile standby charge — Form RC18 states that the cost of the automobile must be at least equal to the fair market value. We invite CRA's explanation.

g. Section 3 of the Revised T1134 Summary. Form T1134 requires disclosure of each corporation that is not dealing at arm's length with the reporting entity and that has an equity ownership percentage in any foreign affiliate of the reporting entity. In a tiered corporate structure, the requirement produces a

[1] Over the past several years, the U.S. Internal Revenue Service has been implementing a secure email system to correspond with large-file taxpayers during audits. All or nearly all such cases now employ that system.

significant amount of redundant reporting. CRA has indicated that it is considering a policy change to relieve redundant reporting. We invite CRA to provide an update on whether the burden of redundant reporting in respect of T1134 may soon be diminished or eliminated.

h. Form T1134 (Dormant or Inactive Affiliates). Until 2012, CRA afforded relief from filing Form T1134 in respect of dormant or inactive foreign affiliates (hereinafter the "Administrative Relief"). CRA defined a "dormant or inactive" foreign affiliate as one with less than $25,000 gross receipts during the year and less than $1 million in asset fair market value throughout the year. The 2012 revision to the Form T1134 instructions states that the *total* cost of all foreign affiliates must be less than $100,000 (hereinafter the "Aggregate $100,000 Threshold") for *any* foreign affiliate to be considered "dormant or inactive."

In response to a tax roundtable query at the May 2013 Canada Health and Life Insurance Association conference, CRA stated that the previous threshold for dormant or inactive foreign affiliates created a reporting gap between Form T1134 and Form T1135 (*Foreign Income Verification Statement*). TEI believes that the determination of dormancy and inactivity for reporting purposes should be an entity-by-entity determination rather than an aggregate determination. Moreover, the Aggregate $100,000 Threshold is impractically low. We urge CRA to consider reinstating the Administrative Relief. Will CRA consider making this change?

i. CRA Collections Policy. Upon the issuance of a Notice of Assessment or Reassessment (NOA or NOR), the CRA accounting system will automatically offset that liability with any refund balance on hand from any tax or taxation year. As a result, when taxpayers receive the NOA or NOR (say, for an income tax audit) in the mail and promptly pay the liability, they often find that a GST refund has already been offset against the liability. As a result, the taxpayer's payment creates an overpayment that must either be reallocated between tax accounts or refunded to the taxpayer. CRA's offset practice thus creates significant reconciling issues for both CRA and taxpayers.

In addition, some taxpayers report receiving calls from CRA collections officials even before receiving an NOA or NOR, let alone before the expiration of the 15-day grace period afforded to make a prompt payment of the NOR or NOA without incurring an interest charge.

Would CRA consider reprogramming its standardized accounting system to delay automatic offsets of extant refunds against NORs or NOAs until at least 15 days elapse from the date an NOR or NOA is issued? The 15-day period corresponds to the grace period afforded to taxpayers to receive and promptly pay an NOR or NOA. In addition, since it is difficult for a taxpayer to respond to an inquiry from a CRA collections official prior to receipt of an NOR or NOA, we recommend that CRA consider refraining from calling large file

taxpayers before 15 days have elapsed from the date of an NOR or NOA. We invite CRA's response.

4. Dispute Resolution

Taxpayers are experiencing lengthy delays in resolving cases and controversies at Appeals. TEI invites a discussion of the status of the workload for the Appeals Branch, including CRA's comments on the following:

a. What is the current estimated elapsed time to resolve a large-file case at Appeals after an objection is filed?

b. Are there any initiatives underway or under consideration to reduce the backlog of cases at Appeals?

c. From TEI's perspective, one factor contributing to the current backlog of cases is that there seem few incentives for the Audit Division to resolve controversies at the audit stage. Indeed, some taxpayers report receiving adjustments that are clearly unsustainable at Appeals. TEI believes the verification process should be used to identify, audit, and resolve issues with taxpayers. Indeed, far more issues should be resolved at the audit stage because once controversies move past the audit stage, the cost and time to resolve the issue increases substantially.

To frame the discussion, TEI invites CRA's comments on the following:

i. Are any initiatives being considered to reduce the number of unsustainable adjustments passed from the Audit Division to the Appeals Branch?

ii. Does CRA have metrics to measure the *quality* of the adjustments moving from Audit to Appeals? Can such metrics be adapted to evaluate the Audit Division's performance?

iii. Does CRA employ a quality assurance function to review audit findings prior to the issuance of proposed adjustments or submission of the files for reassessment?

iv. Can CRA provide suggestions to taxpayers about how to resolve more issues at the audit level as part of the verification process?

5. Operating Expenses Paid by an Employee

Publication T4130(E) *Employer's Guide — Taxable Benefits and Allowances* provides the following guidance about automobile taxable benefits:

Reimbursement of operating expenses

a) *If the employee reimburses you in the year or no later than 45 days after the end of the year for all operating expenses (including the GST/HST and PST) attributable to personal use, you do not have to calculate an operating expense benefit for the year. If the employee reimburses you for part of the automobile's operating expenses in the year or no later than 45 days after the end of the year, deduct the payment from the fixed-rate calculation of the benefit.*

b) *If you provide an automobile to an employee and you require your employee to pay a third party for part or all of the operating expenses (including the GST/HST and PST) in the year, administratively, we will allow you to deduct the portion of the payments attributable to personal use from the fixed-rate calculation of the operating expense benefit.* ***Note:*** *The portion of the operating expenses that relates to personal use is the percentage obtained by dividing the number of personal kilometers by the total number of kilometers driven by the employee during the year while the automobile was available to the employee.*

Paragraph (a) suggests that the employee's taxable benefit can be reduced by the full amount of reimbursements paid to the employer, but that operating expenses paid by an employee to a third party must be prorated by a ratio of personal kilometers driven to total kilometers driven. The rationale for the distinction and the inconsistent treatment of reimbursements to employers versus payments to third parties is unclear. TEI recommends that CRA amend the guidance to allow recognition of the full amount paid by the employee to the third party. We note that Form RC18 (*Calculating Automobile Benefits for 2012*) and the "Automobile Benefits Online Calculator" treat reimbursements to the employer and amounts paid by the employee to third parties identically: the operating expense benefit is fully reduced by the payments and no proration is applied.

Paragraph (b) states that the "fixed rate calculation of the benefit" can be reduced by reimbursements of operating expenses to the employer and operating expenses paid by the employee to a third party. What is CRA's position on the treatment of reimbursements to the employer or operating expenses paid by employees to third parties under the optional-method calculation? Can the operating expense benefit be reduced by reimbursements to the employer or payments to third parties under the optional method?

6. CRA Audit Deduction

When the Audit Division makes an adjustment in respect of an income inclusion item that is a timing difference by increasing taxable income in a particular year (Year 1), will the Audit Division tax the same income in a subsequent year (Year 2)? To illustrate the question, assume a taxpayer enters into an agreement in Year 1 to provide services in Year 2. The taxpayer receives $100M for those services in Year 1 but includes nothing ($0) in taxable income in that particular year and includes $100M in income in Year 2. CRA Audit concludes that the $100M should be included in taxable income in Year 1, determines that no

reserve is available to offset the inclusion, and reassesses. The taxpayer files a Notice of Objection for Year 1. CRA Audit then audits the subsequent year and does not reduce taxable income by $100M in Year 2, notwithstanding that subsection 152(4.3) allows consequential assessments beyond the normal reassessment period where a balance, including taxable income, is changed as the result of a decision on appeal. The result is that the taxpayer would be subject to double taxation on $100M (since the amount is included in taxable income in both Year 1 and Year 2) pending resolution of its Notice of Objection. Moreover, if the taxpayer is a large corporation, it is required to remit 50 percent of all taxes in dispute on filing the Notice of Objection. On the facts of the example, the taxpayer would remit 50 percent of the taxes to pursue its appeal of the issue for Year 1 while also effectively paying the full amount of tax in Year 2, as filed. Subsection 248(28) seemingly does not support CRA's taxing the same income twice. We invite CRA's comments on the propriety of taxing the same amount twice.

7. Employer Provided Social Events

CRA treats the cost of employer-provided social events that are available to all employees at a particular place of business as a nontaxable benefit, provided the cost per employee is *reasonable*. A now cancelled administrative guideline interpreted the reasonable event cost as $100 per person. (*See* ITTN-15 – *Income Tax Technical News* (December 18, 1998) [cancelled]). Fifteen years have elapsed since that interpretation was issued, but the $100 per person cost is seemingly still the controlling guideline. Owing to cost inflation, the nearly automatic imposition of gratuities of 15-18 percent for group events, and the application of taxes to event costs, we believe the $100 amount is too low. We recommend that CRA publish a new guideline reflecting an increased amount for a reasonable per-employee cost. We invite CRA's reaction to TEI's recommendation.

8. Regulation 102 Waivers

We invite a discussion of CRA's views in respect of its administration of Regulation 102, especially applications for waivers of withholding (Form R102-R), as follows:

a. Increasingly, taxpayers are finding that even *timely filed* R102-R waiver applications are being rejected. The stated basis for the rejection is that the relevant non-resident employer failed to file Form R105 to obtain a waiver of withholding under Regulation 105. TEI believes the requirements for, and policy underlying, an R105 waiver are separate matters from the *employee-level* R102-R requirements. Would CRA please explain the policy reason for the linkage between the R102-R waiver and the R105 waiver?

b. CRA currently requires that R102-R requests for waivers of withholding be made 30 days prior to the start of employment services in Canada or the initial payment. Due to administrative delays and the requirement to obtain an ITN or SIN prior to submission of the application, the waiver request can rarely be filed that far in advance. To enable more efficient compliance with the Regulation 102 regime, would CRA permit retroactive filing of the R102-R waiver?

In its 2008 report, the Advisory Panel on Canada's System of International Taxation recommended elimination of Regulations 102 and 105. Although TEI agrees with the Panel's recommendation and believes repealing the rules or replacing the waiver process with a self-certification system would be the better course, TEI representatives have met with CRA to discuss and develop other, more practical approaches to comply with the current Regulation 102 requirements.[2] We request an update on CRA's views and proposals for simplifying the Regulation 102 administration and waiver process.

In connection with that discussion, we note that the $10,000 threshold in Article XV(2) of the Canada-U.S. Treaty has not been adjusted for inflation since 1980.[3] Since revisions to treaties take considerable time to negotiate, we recommend that CRA consider implementing a reasonable administrative guideline to reduce the burden of adhering to such a low threshold in its administration of R102 waivers. We encourage CRA to work with the Department of Finance to develop a higher *de minimis* threshold and other relief from the current Regulation 102 requirements.

9. Tax Residency Certificates

When entering a competitive bidding process for contracts in foreign jurisdictions, Canadian businesses are frequently required to provide — on an urgent time frame — tax residency certificates to their customers. CRA does not issue tax residency certificates in the name of a Canadian partnership (as defined in the ITA), so separate residency certificates must be obtained in the names of each of the entity's partners. Many Canadian companies experience commercial disadvantages with international competitors where they are required to explain to foreign customers — who are unfamiliar with tax legislation and Canadian administrative practice — how corporate residency certificates are obtained in a partnership setting. (The challenge is compounded where the bidding partnership is in a tiered-partnership structure). In some cases, the customers are unwilling or unable to countenance the delay required to obtain the certificate for all the partners, thereby resulting in lost commercial opportunities for Canadian companies.

Would CRA be willing to issue Canadian tax residency certificates in the name of a Canadian partnership on the basis of the Canadian residency of all its partners? We appreciate that a Canadian partnership does not have a tax residence *per se*, but in certifying the Canadian residence for all of an entity's partners the Canadian residency of the partnership can effectively be established. If the CRA were willing to issue a Canadian tax residency certificate in the name of a Canadian partnership on the basis of CRA-approved qualifying status of the Canadian partners, the competitive posture of Canadian businesses would be significantly improved. We invite CRA's response.

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[2] While TEI appreciates the July 12, 2013, Finance release relating to subparagraph 102(6) of the Regulations, which introduced exceptions for those employed with prescribed international organizations and prescribed international non-governmental organizations, and the recent CRA administrative relief for conference attendees, those measures do not go far enough.

[3] To reflect the current costs of doing business, changes in the Consumer Price Index suggest that the $10,000 *de minimis* threshold should be close to $28,000 in 2013.

10. Foreign Tax Credits

Assume the following facts: An employee moves from Country A to Canada in December 2012 and becomes a resident of Canada for tax purposes. In February 2013 the employee receives a bonus from the Country A employer for services rendered prior to departure. The amount is fully taxable to the employee in Canada in 2013. The amount is also fully taxable to the employee in Country A, but Country A treats the income as taxable in 2012 rather than 2013 since the bonus relates to services performed in 2012. Would CRA allow the employee to use the 2012 tax paid in country A as a foreign tax credit on the bonus amount received and taxable in Canada in 2013?

Conclusion

Tax Executives Institute appreciates this opportunity to present its comments and questions. We look forward to discussing our views with you during our December 3, 2013, liaison meeting.

Respectfully submitted,

Tax Executives Institute, Inc.

By: 

Shiraz J. Nazerali
Vice President for Canadian Affairs