Minutes

of

Liaison Meeting Between

TAX EXECUTIVES INSTITUTE, INC.

and the

THE DEPARTMENT OF FINANCE

DECEMBER 5, 2012

1. Update on Pending Projects and Carryover Issues

a. *Functional Currency Reporting Rules:*

The Department has received a number of submissions relating to the functional currency reporting rules, but until recently internal resources have been focused on other priorities, such as Bill C-48. This file has been re-activated and the Department is considering amendments that would make these rules function better.

b. *General Legislative Update:*

Since Bill C-48 has been tabled and will hopefully receive royal assent in the near future, the Department will turn its attention to other specific items, including continuing to catch up with legislation to address outstanding comfort letters. The Department will probably release small technical packages and afford the public an opportunity to comment through consultations.

c. *Tax Consolidation System:*

This is still an active project and a great deal of work is going on behind the scenes. The Department, however, is finding it challenging to reconcile the desires of taxpayers with provincial fiscal concerns regarding potential profit-shifting between provinces. There is no data available concerning loss usage within the provinces that would alleviate the provincial concerns or afford an understanding of the potential impact of proposed changes. This presents a roadblock. The Department continues to be active both internally and with OECD, reviewing other country experiences. Next steps are under consideration.

2. Part VI.1 Tax and Paragraph 110(1)(k)

It is not the Department's intention to revisit the 2010 amendments to paragraph 110(1)(k). The Department has tried to strike a proper balance, but it is difficult to do so given the wide range of combined federal-provincial tax rates, reflecting different types of corporations, varying provincial tax rates, and different mixes of inter-provincial taxable income allocations. The Department believes the current legislation reflects a reasonable balance between fairness and simplicity.

The current Part VI.1 regime provides a mechanism under which the Part VI.1 tax is shared with the provinces under the *Federal-Provincial Fiscal Arrangements Act* (based on the provincial allocation of the dividend payer's taxable income). Because a portion of that tax represents a proxy of the federal and provincial income tax that the corporation would have otherwise paid, that tax is deductible in computing the corporation's federal and provincial taxable income (the deductible amount can also be included in the corporation's federal and provincial non-capital loss pools). During the discussion, TEI representatives have suggested that a tax credit mechanism should be used whereby regular corporate income tax would be applied against Part VI.1 tax. The Department is not inclined to move to such a tax credit mechanism because this would require a complex set of rules in order to pool and track provincial corporate income taxes and loss carryovers that would be applicable against the Part VI.1 tax paid under the federal *Income Tax Act*. The current system provides a much simpler way to share the Part VI.1 tax with the provinces through the application of a single federal-provincial Part VI.1 tax.

3. Subsection 93(2)

The Department believes that subsection 93(2) is necessary to protect the Canadian tax base. Relieving provisions have been added in the past and other amendments were tabled on November 21st in Bill C-48. No additional relieving provisions are under consideration.

If changes were introduced to treat preferred shares similar to debt under this provision, other consistency-related changes to the Act would also likely be considered (*e.g.*, denial of exempt surplus on distributions in respect of preferred shares).

4. **Canada-U.S. Treaty — Withholding Tax Exemptions for Payments of Certain Royalties**

The tax policy remains unchanged and therefore the Department is not at this time planning to exchange notes with the United States in order to exempt royalty payments in respect of broadcasting rights from withholding tax. However, the Department will consider representations from taxpayers explaining concerns about the Treaty provisions.

5. Upstream Loans

a. This issue was addressed by new subsection 90(11), which was introduced in the October 24, 2011, Notice of Ways and Means Motion and included in Bill C-48. New subsection 90(11) permits the creditor affiliate to aggregate "downstream surplus" for purposes of paragraph 90(9)(a). The Department of Finance is not considering any further amendments.

b. This issue was addressed by new subsections 90(2) and 90(3), which were introduced in the October 24, 2011, Notice of Ways and Means Motion and included in Bill C-48. Subsection 90(2) allows pro-rata distributions received on a "qualifying return of capital" (QROC), as defined in subsection 90(3), to be characterized as a return of capital. QROC treatment is elective.

6. Eligible Property under Subsections 85(1.1) and 97(2)

a. *Section 85.* No change is being contemplated to permit real property inventory to be rolled over because the Department's policy is not to permit real property inventory, which gives rise to business income on disposition, to be converted to a capital gain. In the *Loyens* case, the disposition of the land was sourced as business income.

b. *Section 97.* The Department will consider submissions in respect of the treatment of SDOs but would want to understand the circumstances under which, and the reasons for, transferring SDOs to a partnership.

7. Automobile Benefit

As part of a broader review of the area, the Department will consider the effect of an employer's self-insurance of leased automobiles on an employee's taxable benefit amounts.

8. Bilateral Safe Harbours

The Department and CRA have been actively exploring this issue through their participation in OECD Working Party No. 6. The Department sees the potential benefits of adopting bilateral safe harbours, but would like to understand the business perspective better and will need to see the final results of the OECD project. The Department invites comments from TEI on what safe harbours would be useful and what TEI's position is in respect of interest rates, low-cost services, *etc.*

9. Subsection 34.2(17)

a/b. The Department agrees that, in year 2, the operation of subsection 34.2(17) in computing the revised ASPA amount, the ASPA component C should be nil. [Note: Subsequent to the meeting, a technical amendment reflecting this change was included in the draft legislative proposals released on December 21, 2012.]

c. In respect of the definition of the ratio of D/E in subsection 34.2(17), the Department expressed its willingness to further consider the issue raised. [Note: Subsequent to the meeting and after further review, the Department said it is of the view that the current wording does not need to be revised because it actually provides for the appropriate pro-rata calculation – that is, the number of days that are "both in the year and the particular period [only some of the days in the particular period are also in the taxation year]" divided by all of the days in the "particular period".]

10. Subsection 15(2.1) and Partnerships

The Department agrees that the policy intent of subsection 15(2.1) is not to capture the situation described but if other partners are connected to the shareholder of the General Partner, even if a small percentage, then it should be caught. This is not the only situation that has been brought to the Department's attention. Consideration is being given to all situations raised and whether to recommend appropriate relief in a future technical release.

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