Summary Minutes of Department of Finance Meeting on

Questions submitted with respect to Pending Canadian Income Tax Issues

December 7, 2011

1. Update on Pending Projects and Carryover Issues

(a) *Advisory Panel on Canada's System of International Taxation*

(1) The Department does not share the view implied in the question that Finance is moving away from the Advisory Panel's recommendations; rather, the Department is moving in parallel with the Panel's recommendations as it makes incremental changes to improve the current system. No final decision has been taken by the Department about whether the exemption system should be broadened to cover all foreign active business income earned by foreign affiliates and capital gains and losses realized on the disposition of shares of a foreign affiliate that derive all or substantially all their value from active business assets.

(2) As explained in the 2010 Budget, the Advisory Panel's recommendations are being considered on an on-going basis. The Department of Finance is taking an incremental approach to reform the current system and there are no specific recommendations the Department can provide further information about.

In respect of withholding tax requirements for employees under Regulation 102, there was a follow-up meeting with TEI representatives after the December 2010 liaison meeting. In addition, there were subsequent discussions between Canada Revenue Agency and the Department. On-going work on Regulation 102 is progressing.

(b) *Loss Transfer System*

The Department is continuing its study of the various issues and approaches to addressing the issues in this complex area and will announce its next steps in the coming months.

(c) *Functional Currency Reporting Rules*

There are no new developments on this subject. The Department has received a number of suggestions and continues to consider TEI's comments along with those in other submissions. There are a number of interrelated issues that must be considered together before moving forward. The timeframe for the review will likely be within the next year.

2. Calculation of Amount under Subparagraph 247(3)(b)(ii)

Finance has not considered this issue before and thus cannot be definitive in its response**.** The Department's current thinking is that a taxpayer-by-taxpayer approach for the determination and assessment of penalties is the proper approach; hence, an amendment to the Act appears unwarranted. Finance observed that if appropriate contemporaneous documentation was maintained, there should likely *not* be a penalty in the situation described. They also noted that the issue involves the interaction of the transfer pricing rules under section 247 with the source of income rules under section 4.

3. Subclause 95(2)(a)(ii)(D)(IV)

The Department has received other submissions on this issue and the matter is under consideration and expects to announce its conclusion in 2012.

4. Comfort Letters

In response to the Auditor General's 2009 report, the Department has worked assiduously to reduce the backlog of outstanding Comfort letters. Rather than develop a single, comprehensive package of draft technical amendments, the Department has released a series of smaller, focused legislative packages — each of which has addressed a portion of the backlog. For example,

- On November 5, 2010 a package of legislative proposals was released that covered 20 Comfort letters;
- The August 16, 2011, package addressed another 10 Comfort letters; and
- Approximately 30 Comfort letters were addressed in the October 31, 2011, package.

Currently, approximately 40 Comfort letters remain outstanding for which draft legislation has not been released for public comment. The prioritization of the amendments for inclusion in a draft technical package depends on a number of factors, including whether the issues are addressed in Comfort letters in the public domain, as well as the Department's best estimate of the number of affected taxpayers. The age of a Comfort letter is also a factor, with the Department attempting to address the oldest items first. Comfort letters remain a priority and the Department believes it has made significant progress whittling away the backlog. Ultimately, though, decisions

about the timing of release, scope, and subject matter of legislation are at the Minister's discretion.

5. Upstream Loans

(a) The Department indicated that CRA is an independent agency that is not under the supervision, direction, or control of the Department of Finance. Although CRA's rulings are presumptively correct interpretations of the Act, the rulings are not entitled to deference when the Department of Finance is evaluating whether the tax policy evinced in the interpretation should be sustained or maintained. In other words, where there is a sound reason for implementing a tax policy change, the Department of Finance is not bound by the policy underlying the current legislation, by its prior views, or by CRA's interpretations. The Department added that prudent taxpayers would have anticipated potential changes in the tax legislation and would have designed exit strategies for their structures.

(b) The Department said that the proposals are intended to protect the integrity of the current tax system. The Department has received considerable feedback and comments on these proposals from many organizations including TEI and is reflecting on the comments.

(c) The Department has received a number of submissions questioning the proposed upstream loan provisions, including that the Department should consider refining the proposals so that the reinvestment (or redeployment) of offshore funds in Canada is not adversely affected. The Department had recognized that money may not come back to Canada.

(d) The Department expressed the view that in developing exit strategies for their structures, taxpayers should have recognized the possibility of incurring foreign exchange gains or losses. The Department, nonetheless, is considering the submissions on this issue.

(e) The Department declined to comment on this issue.

(f) The Department noted that taxpayers will have two years to restructure their affairs, but added that it is considering submissions on the grandfathering approach.

6. Revocation of Waivers Filed During the Extended Reassessment Period

The amendments relating to waivers in the July 16, 2010, draft legislation (as well as the other provisions in that draft legislation) remain outstanding. The Department remains committed to moving this legislation forward. The timing of the release of the legislation and the introduction of bills is a prerogative of the Minister of Finance.

7. Accountant's Privilege

The common law privilege for legal advice was developed to protect the lawyer's duty to promote the administration of justice. The Department of Finance believes the objective of the TEI request is to "level the playing field" between accountants and lawyers in respect of tax advice and is not necessarily about promoting administration of justice. Accountants do not have the same duty to the public. Hence, Finance does not believe the issue should be addressed via tax policy.

The Department also believes it important to defer to CRA on the interpretation and enforcement of its policy on access to workpapers because CRA would not make frivolous requests. While the Department of Finance will continue to monitor developments in other countries about this subject, it is not inclined to pursue an extension of privilege to accountant documents or workpapers. The Department noted that an extensive consultation on the subject of access to accountants' workpapers was recently completed by the CRA (with input from the CICA) and believes that CRA's position is reasonable and fair. CRA has also indicated that it will follow a policy of restraint in making requests. Finance is not interested in legislating restrictions on CRA's access to documents that may inform CRA's ability to conduct a proper and fulsome audit of Canadian taxpayers. For example, there are areas of the Act where a taxpayer's purpose is important; if CRA does not believe that a taxpayer is being transparent about its purpose, they may request the work papers if they believe the documents will shine a light on the taxpayer's purpose.

8. Eligible Dividend Designations

Q. Would the Department consider permitting corporations to make a fixed-dollar designation for a period as being paid from the corporation's LRIP with any remaining amount of dividends being deemed an eligible dividend?

A. The Department appreciates the complexity of the issues and acknowledged it has received submissions and recommendations for changes to the legislation. Those recommendations are under consideration. The Department expressed the view that additional submissions are unnecessary.

Q. Would the Department consider adding an election for excess eligible dividend designations to address situations where the actual amounts change subsequent to the date designations are required to be made whether because of changes in (1) the amount of LRIP or (2) the number of public company shares outstanding?

A. If the election under subsection 185.1(2) is filed within the 90-day deadline, the corporation will not be penalized and the shareholders will be deemed to receive an ordinary dividend for the excess amount. The Department acknowledged, however, that, as a practical matter, in some circumstances, it may be more difficult to meet the election requirements.

As a historical matter, the Department said, the legislation was enacted to achieve integration on the taxation of dividends. A discussion ensued as to whether the continuance of the dual-rate Dividend Tax Credit is necessary now that the tax rate differential between ordinary and eligible dividends has declined.