TAX EXECUTIVES INSTITUTE, INC.

INCOME TAX QUESTIONS

Submitted to

CANADA REVENUE AGENCY

NOVEMBER 15, 2016

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 during the November 15, 2016 liaison meeting. If you have any questions about the agenda in advance of the meeting, please do not hesitate to call Steve Perron, TEI's Vice President for Canadian Affairs, at 514.841.3412, or Paul Magrath, Chair of TEI's Canadian Income Tax Committee, at 905.804.4930.

A. Introduction

Question 1.

In prior years, the Assistant Commissioner for Legislative Policy and Regulatory Affairs has provided a helpful update on the Agency's overall strategic direction. We invite the Assistant Commissioner to provide an update that includes his thoughts on the vision for the future of the branch and feedback on the role TEI can play in achieving that vision.

CRA Response:

Since being appointed as Assistant Commissioner of the Legislative Policy and Regulatory Affairs Branch (LPRAB) in October 2015, Mr. Geoff Trueman, has continued to lead LPRAB in its vision to support the Canada Revenue Agency (CRA) in achieving excellence in program compliance and service delivery to all its clients and to maintain a highly educated, experienced and specialized staff. LPRAB remains committed to optimizing the use of technology to enhance services and streamline operations; as well as to enhance communication and engagement with our stakeholders.

Prior to joining the CRA, Mr. Trueman was the General Director of the Tax Policy Branch at the Department of Finance Canada, where he was responsible for the economic and quantitative analysis to support policy analysis and development by other sections.

Mr. Trueman is happy to share this leadership role with Ms. Cathy Hawara, who was appointed as Deputy Assistant Commissioner of LPRAB in June 2016. Prior to her appointment, Ms. Hawara was the Director General of the Charities Directorate within LPRAB where she was responsible for the overall management of all program activities related to the provisions of the Income Tax Act regarding registered charities.

Under their leadership, LPRAB aims to deliver on its diverse mandate, including to ensure that Canadians have access to the services they need and to provide timely and accurate information in order to promote voluntary compliance. Specifically, LPRAB's mandate includes being the ultimate authority for the interpretation of tax and benefits related legislation. It establishes and clarifies the interpretation of tax laws and is responsible for recommending legislative amendments to the Department of Finance on behalf of the whole of CRA.

LPRAB continues to focus on strengthening public confidence through its collaboration with stakeholders in an effort to find ways to better increase effectiveness and efficiency in the delivery of all its programs and services, but especially of late in both the Income Tax and GST Rulings functions. As in the past, each Directorate within LPRAB will continue to build on established relationships with stakeholders to improve the accessibility and range of information products available. In this regard, maintaining the ongoing relationship with TEI continues to be a priority for both LPRAB and the CRA.

B. Follow-up Questions and Carryover Items from Prior Years

Question 1. *Employer-Provided Social Events*

As discussed at the 2013 Liaison Meeting with the CRA, and reviewed again at last year's meeting, the CRA was prepared to consider an upward adjustment to the allowable amount for employer-provided social events to take inflation into account since the guidance was first introduced almost 20 years ago. We are listing below some data points on what these average costs are for different cities and we kindly request the CRA provide us with an update on this review. TEI also recommends the CRA increase the employer-provided social-events cost threshold to $200 per person to account for the rising costs of providing social events to employees, with any amounts above this threshold being treated as a taxable benefit to the employee. The following information about the costs of employer-provided social events was accumulated from TEI members and relates to holiday-season parties in the cities listed below, which show the difficulty in hosting such events in metropolitan areas under a $100 per-person limit:

	Calgary	**Edmonton**	**Montreal**	**Sudbury**	**Toronto**	**Vancouver**
Food, beverage, entertainment	$125.00	$125.00	$153.00	$103.00	$115.00	$119.00
GST/HST/QST	$6.25	$6.25	$22.91	$13.39	$14.95	$21.42

Gratuity (18%)	$22.50	$22.50	$27.54	$18.54	$20.70	$5.95
Total	$153.75	$153.75	$203.45	$134.93	$150.65	$146.37

In CRA's response to TEI's 2015 follow-up on this matter, CRA noted that ancillary costs, which we interpret to mean costs such as taxi fares and overnight accommodations, are excluded from the $100 per-person threshold, and therefore certain inflationary pressures have already been reflected in the threshold. However, TEI respectfully does not believe the increasing cost pressures in the hospitality industry are adequately included in the $100 threshold.

CRA Response:

CRA is prepared to recommend increasing the social events policy threshold to $150 from the current $100 per attendee. The policy will continue to be based on a threshold rather than an exemption. This recommendation must still be reviewed by the internal government stakeholders.

Question 2. *Gift Cards*

During the 2015 liaison meeting, the CRA mentioned it would review the guidance on gift cards provided to employees to consider amending that guidance so that gift cards would qualify for exclusion from treatment as a taxable benefit. This would be a welcome change as it is an issue that creates a significant compliance burden on our members to track, report, and appropriately tax what are arguably nominal amounts. Can the CRA provide an update as to the consideration of this issue? In addition, we recommend that gift cards with a value at or below $50 each, and at or below $200 in total over a year, not be treated as a taxable benefit with the full amount of any gift card above $50, or any amounts received above $200 annually, treated as a taxable benefit.

CRA Response:

CRA received, reviewed, and considered the TEI submission. CRA will not be including gift cards in its Gifts and Awards policy.

CRA has a gifts and awards policy, which allows employers to recognize certain personal and professional milestones in their employees' lives. The policy allows an exemption of up to $500 for non-cash gifts or awards, provided that the reason for the gift or award is consistent with the definition contained in the policy.

It is CRA's position that cash and items that essentially function as cash are included in income. Gift cards essentially function as cash, are not included in the policy, and are therefore not eligible for the exemption.

In conclusion: CRA's position regarding gift cards remains unchanged.

Question 3. *Section 55(2) Guidance on Determination of Safe Income*

It was mentioned at the 2016 Annual TEI Conference that Rulings will be working on a safe-income publication. We understand, however, that a formal publication may not be forthcoming, but that the CRA would be willing to provide guidance to assist in situations where there is ambiguity resulting from various amendments to section 55, in addition to its previously published guidance. TEI would welcome the opportunity to consult with the CRA on a number of practical concerns that are emerging as taxpayers consider how to work through the recent changes to section 55.

As the CRA is aware, the recent changes in this area are of great interest and concern to many taxpayers in Canada, particularly for large businesses that often have a long-standing history of Canadian operations and are struggling to determine workable approaches to safe-income calculations. Historically, taxpayers have not had to rely on such calculations to support intercompany cash dividends, and there are considerable practical issues related to these calculations, such as information not being available due to archival information loss, documentation destruction policies, corporate reorganizations, etc. In an effort to provide the CRA with greater insight into some of the issues that taxpayers are dealing with, we present the following as examples of areas about which we would like to commence a dialogue and, ideally, a consultative process. While TEI welcomes any thoughts the CRA may have to the following areas, we offer these as just a few examples of a broader range of administrative issues we believe would be best addressed through a consultative process.

a. Given the historical records required to prepare safe income calculations, what type of practical approaches and assumptions could the CRA accept when it comes to relying on the amounts determined (i.e. accounting retained earnings) as a starting point to support the opening balance of "safe income on hand" as of the time these provisions were enacted?

CRA Response – 3a:

In determining whether a dividend meets the exception in paragraph 55(2.1)(c) of the Income Tax Act, the onus is on the taxpayer to provide support for the calculation of the income earned or realized by any corporation after 1971 and before the safe-income determination time.

Previous positions from the CRA and the Courts have used the expression "safe income on hand." It appears that the concept of safe income on hand might not have been used consistently in different publications and cases.

For the purposes of this answer, we refer to "safe income" to describe the "income earned or realized after 1971 and before the applicable safe income determination time" as determined under paragraphs 55(5)(b) and (c). In order to avoid possible confusion, we will refer to "safe income that can reasonably be considered to contribute to the capital gain on a share" to describe the portion of the safe income that was sometimes referred to as "safe income on hand" in previous positions and jurisprudence.

The onus is on the taxpayer to provide support for the calculation of safe income that can reasonably be viewed as contributing to the capital gain on a share. The CRA expects the supporting documentation to be organized as an accumulation of year-by-year computations. Safe income has to be determined following the requirements of paragraphs 55(5)(b) and (c) (starting with net income for income tax purposes) and adjusted to reflect the portion of the safe income that can reasonably be considered to contribute to the capital gain on a share.

In the course of a compliance audit where a detailed computation of the safe income that can reasonably be considered to contribute to the capital gain on a share is not provided by the taxpayer and the taxpayer offers an alternative proxy such as the accounting retained earnings or adjusted retained earnings balance, the CRA would proceed as it would in any circumstance in the course of an audit where optimum audit evidence has not been provided by the taxpayer. The CRA auditor would determine if what was provided is a reasonable effort to compute an accurate estimate. In some very rare cases, the CRA auditor might conclude that retained earnings is a fair proxy for safe income on hand but only after a very stringent validation process.

The calculation of safe income has a purpose of substantiating the claim that a dividend is not subject to the application of subsection 55(2). We should note that an incorrect claim could be subject to the application of subsections 152(4), 163(2) or 239(1), depending on the circumstances.

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b. Could the CRA provide access to historic tax returns, assessments, and reassessments dating back to the incorporation of the entities required to prove "safe income on hand"?

CRA Response – 3b:

As it stands now, when a taxpayer makes a request to the CRA to obtain a copy of income tax returns and/or notices of assessment, the CRA will attempt, in regards to available resources, to provide the requested documentation. However, the CRA is not under the obligation of providing such documents and it is not in a position to provide assurances that these requests will be actioned in all cases.

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c. What type of audit practices can taxpayers expect to be adopted and implemented related to supporting documentation used to calculate "safe income on hand"?

CRA Response – 3c:

The audit practices that a CRA auditor typically carries out to verify the calculation of safe income that can reasonably be considered to contribute to the capital gain on a share are similar to audit steps on any other audit issue.

Each component of the calculation will be validated utilizing appropriate documentation provided by the taxpayer. That includes a verification of the portion of the safe income that can reasonably be considered to contribute to the capital gain on each share of the corporation in any given year. This typically involves a validation that a detailed analysis was done using share registers and minute books provided by the taxpayer. The analysis should be carried out for each year and the adjustments should take into consideration any changes in the shareholdings.

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d. Safe income is computed in reference to a share that begins when a taxpayer acquires the share and ends at the safe-income determination time. Under subsection 55(1), the safe-income determination time is the earlier of the time that is immediately after a transaction with an unrelated person as described in subsection 55(3)(a) as part of the series, and immediately before the earliest dividend paid as part of the series. Could CRA provide additional guidance on the safe-income determination time where a company pays a regular dividend, either on a monthly, quarterly, or annual basis but does not enter into a transaction with an unrelated person under subsection 55(3)(a)?

CRA Response – 3d:

In a recent ruling, the CRA took the view that regular, recurring annual dividends would not, in the circumstances of the ruling request, be part of a series of transactions. Accordingly, a ruling confirmed that the safe income determination time in respect of the first and second annual dividends will be immediately before each such dividend.

In addition, in a recent technical interpretation (2016-0633961E5), the CRA considered the situation where a corporation sold its depreciable properties and its eligible capital property before the end of a taxation year and paid a dividend after the sale of the assets but before the end of the year of the sale. We were asked to confirm whether the amounts computed pursuant to subsections 13(1) and 14(1) at the end of the taxation year would be added to the safe income before the safe income determination time with respect to the dividend.

Applying the textual, contextual, and purposive approach, the CRA indicated that it would accept that the safe income immediately before the safe income determination time would include the income computed pursuant to subsections 13(1) and 14(1) if the sale of the assets occurred before that safe income determination time. However, the CRA would also take the position that the portion of the safe income that can reasonably be viewed as contributing to the capital gain on a share would be reduced by the amount of income taxes payable with respect to the income inclusion resulting from that sale.

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e. The CRA's position had been that contingent liabilities and accounting reserves, such as future employee benefits and pension obligations, reduce safe income on hand when they are set up. In *Kruco v. The Queen*, [2003] F.C.A. 284, the court had held that safe income should be reduced by cash outflows. Has CRA's position changed in light of *Kruco*?

CRA Response – 3e:

As discussed in ITTN-37, dated February 18, 2008, the FCA's decision in Kruco requires a second stage inquiry in respect of the calculation of a corporation's safe income to determine whether the income earned or realized was kept on hand (i.e., whether such income can reasonably be viewed as contributing to the capital gain on a share). The decision supports the notion that the safe income should be reduced by actual or potential cash outflows such as non-deductible expenses, contingent liabilities and accounting reserves in the determination of the amount of safe income that can be viewed as contributing to the capital gain on a share.

We welcome any additional questions on interpretative issues.

Question 4. *Regulation 102*

a. Update on TEI Correspondence

The issues associated with Regulation 102 are very important to TEI members in Canada and abroad. On November 17, 2015, a Regulation 102 working group comprised of TEI members met with members of the CRA, including Mickey Sarazin, and members of the Department of Finance. That working group followed that meeting with a letter dated March 17, 2016, a copy of which is attached hereto as Appendix "A." At the May 2016 TEI Canadian Tax Conference, the CRA's Randy Hewlett commented that the CRA was reviewing and considering the March 17, 2016 letter. That letter provided an example illustrating a situation in which a corporation could view the rules as burdensome for various reasons and made six recommendations to simplify the process, including simplifying the prescribed Form RC473. Can the CRA provide an update on its position with respect to each of the letter's

recommendations and, if a particular recommendation is not expected to be adopted, the reasons why?

CRA Response – 4a:

R1 - Eliminate the need for qualifying non-resident employers to complete Form RC1 if they already have a Business Number.

We have discussed this recommendation with our colleagues in the Business Number Policy Section and they have advised that they will review their current procedures further to see if an RC1 or RC1b is required to obtain a BN for the purposes of employer certification.

R2 – Eliminate the need for qualifying non-resident employers to complete Form Rc59 if they already authorized the representative listed in Section 2 of the RC473.

We are in the process of finalizing updates to Form RC473 and have adopted this recommendation and the requirement to attach Form RC59 has been removed.

R3 – Eliminate any references to filing applicable income tax returns on the RC473 as a condition of employer certification.

We agreed with this recommendation back in March and we changed this obligation so that an employer must complete and file Canadian income tax returns as required by the Income Tax Act for those calendar years covered by the certification period. Therefore, an employer who is not carrying on business in Canada is not required to file a Canadian income tax return as a condition of their employer certification.

R4 – Eliminate boxes 19, 20, and 21 on Form RC473.

These boxes have been renumbered on the soon to be released form. They are for reporting and processing purposes and are not intended to be used for any audit or workload development activity related to any prior audit periods.

R5 – Support TEI's past request to the Department of Finance to eliminate the $10,000 remuneration threshold for determining whether T4 reporting must be made in respect of a qualifying non-resident employee.

This is a tax policy issue and we believe that you should continue to work with the Department of Finance should you wish to see this regulation revised.

R6 - Extend the deadline for filing Form RC473 from March 1, 2016 to the later of June 1, 2016 of the date of Royal Assent of the legislative proposals.

We considered this recommendation at the time and determined that the March 1, 2016 filing deadline that allowed for the issuance of a retroactive certification letter back to January 1, 2016 was ample time for a non-resident employer to apply for employer certification.

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b. Certification update

Can the CRA provide an update on the Form RC473 certification process (including any statistics that may be available on the number of applicants, number of certifications granted, issues experienced to date, etc.), related audit activity, and whether the CRA is considering any other changes to the process or prescribed Form RC473?

CRA Response – 4b:

Since the implementation of non-resident employer certification in January 2016, we have approved approximately 1,720 applications. We continue to receive applications each week and are now receiving new applications for the 2017/2018 certification period.

Only 19 applications have not been approved to date. The reason for not approving is the employer failed to provide and/or obtain a Business Number.

484 of the approved applications were also first time Business Number registrants.

We have not experienced any major issues at the application stage other than some applicants not completing the entire application.

414 verification letters have recently been issued in order to ensure that the certified employers are meeting the conditions of their employer certification agreement.

The verification letters are asking for information on the number of employees who have come to Canada to date, an explanation of how they verified their employee's country of residence and tax treaty status, and documentary support showing:

- the number of days each qualifying non-resident employee was either working in Canada, or present in Canada,
- arrival and departure dates, and
- the employment income attributable to these days in Canada.

Upon completion of the review, one year extensions will be offered to these employers provided that the employer is meeting their Employer Certification obligations and they have not incurred any compliance issues during the certification period.

Question 5. *Electronic Filing of Mutual Fund Trust Returns and Other Online Services*

In its response to TEI's 2014 liaison-meeting request for an update on electronic filing of tax returns being made available to mutual fund trusts, the CRA stated: "Our strategic goals include exploring the feasibility to offer more enhanced online options that are secure, reliable, and easy to access. As operational realities improve, the Agency may be in a position to target the improvement for the assessments of trust income tax returns." We understand that limited types of trusts are now able to file electronically. Can the CRA provide an update as to when it may be in a position to offer the electronic filing of mutual fund trust returns and other online access to manage such tax accounts?

CRA Response:

Over the next 2 to 3 years, the CRA plans to introduce electronic filing for form T3RET, T3 Trust Income Tax and Information Return. In January 2018, mutual fund trusts and other trusts will be able to electronically file form T3RET when the trust has no taxable income, no tax payable and no refundable credits. This will enable over 80,000 return to be filed electronically, including approximately 350 mutual fund trusts returns. The following year, the CRA expects to increase this service to include taxable returns for mutual funds and the majority of other trusts.

The CRA is currently reviewing options for the introduction of T3 self-service portal options. The CRA cannot provide a date at this time as to when the online services will be available.

C. Administrative Matters

Question 1. *Allocation of Resources & Expertise*

In the 2016 Federal Budget, the Minister announced that $444.4 million would be invested over five years for the CRA to "enhance its efforts to crack down on tax evasion and combat tax avoidance by: hiring additional auditors and specialists; developing robust business intelligence infrastructure; increasing verification activities; and improving the quality of investigative work that targets criminal tax evaders." Can the CRA comment on how these funds will be used? In addition, can the CRA specifically comment on the following issues?

CRA Response:

The investment of $444 million is directly linked to the Minister's mandate to crack down on tax evasion and tax avoidance. These funds will be used in several ways:

- The CRA is expanding its Promoter Compliance Centre (PCC) to centralize all aspects of promoter compliance, including risk assessment and workload development and is establishing specialized promoter audit teams in the field to work exclusively on the promoter audits. The PCC is part of a promoter strategy that will focus on financial planners and marketers who aim their products at less sophisticated taxpayers.

- The CRA launched a hiring process this fall to add new tax professionals to its audit team. These auditors and specialists will audit multinational corporations, as well as increase the number of examinations of high risk taxpayers.

- The CRA will accelerate offshore compliance activities concerning international electronic funds transfers of more than $10,000 to more fully examine potential tax non-compliance across an entire jurisdiction.

- The CRA is continuing to develop its business intelligence infrastructure for gathering and analyzing information that will help detect tax evasion and tax avoidance activities. This will allow the CRA to better target non-compliance in the highest risk areas, increase its audit activities, and improve the quality of investigative work focusing on criminal tax evasion.

- The CRA will embed in-house legal counsel to support the Criminal Investigations Program at the investigation stage of tax evasion cases. Providing legal counsel at the investigation stage will ensure decisions are based on sound legal principles and will ultimately enhance the quality of cases referred to the Public Prosecution Service of Canada for criminal prosecution.

a. *Access to Information Requests*

Taxpayers commonly request information from the CRA under the *Access to Information Act* subsequent to a reassessment in order to access information that the CRA has about the matter. The CRA typically responds to these requests by requesting an extension for its response time beyond the 30-day statutory time limit, often in excess of one year. The CRA has stated in correspondence with taxpayers that meeting the statutory time limit would "unreasonably interfere with the CRA's operations." Will the CRA commit additional resources to the Access to Information branch in order to reduce the time delays in the CRA responding to access to information requests?

CRA Response – 1a:

The Access to Information and Privacy Directorate of the Canada Revenue Agency (CRA) is committed to completing and responding to requests, pursuant to both the Access to Information Act (ATIA) and Privacy Act (PA), as quickly as possible within legislated timeframes. Each Act allows for extensions beyond the initial 30-day statutory limit to account for voluminous requests and varying complexities which would unreasonable interfere with

CRA's operations. To contend with the increases in requests, the ATIP Directorate's financial resources have grown by approximately 5% over recent years.

Furthermore, the ATIP Directorate is continuously looking at ways to improve the efficiencies and effectiveness of our operations and resources. The Directorate is continuing to increase awareness among senior management, offering videoconferencing or webinars to targeted CRA employees and creating additional training products available across the Agency. These are aimed at reducing the volume of out-of-scope and duplicate documents as well as reducing the turnaround time to receive information from offices of primary interest to decrease the time required to complete requests.

Finally, we are encouraging areas of the CRA to increase the use of informal means of disclosure to provide personal information. Taxpayers have a right to complete, accurate, clear and timely information. With this in mind, the CRA provides taxpayers with a number of informal channels to get information, including online portals for My Account for Individuals and My Business Account, over the phone and by mail. These informal channels are frequently more cost effective and efficient for the CRA and demonstrate a commitment to the Government of Canada's Open Government Initiative.

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b. *Appeals Procedures*

Many of TEI's members have experienced a substantial increase in the time it takes to resolve issues at Appeals, possibly due to lack of resources for large-case files and the empowerment to make decisions at Appeals. Large taxpayers that had previously experienced resolutions at Appeals in 12-18 months are now reporting that similar resolutions are taking at least triple the time. This creates an undue burden for the taxpayers who have to pay, or put up security, for 50 percent of the tax owing. Furthermore, due to the length of time to have an appeal resolved, it becomes increasingly difficult to find employees of the taxpayer who have knowledge of the issue, putting successful resolution of the issue in jeopardy. Can the CRA comment on whether and, if so, how any additional resources will be allocated to addressing the backlog of large-case file issues at Appeals? Also, what additional procedures, authorities, and mandates will be provided to the Appeals divisions to conclude large-file case appeals in a timely manner and not create additional backlogs?

CRA Response – 1b:

While the intake of large files varies from year to year, the CRA has not observed a significant increase in the time taken to resolve this type of objections contrary to the statement contained in the question. These objections are complex in nature and the time taken to resolve these depends on a number of factors, including the necessary time to obtain information and discuss the matters with taxpayers. That being said, the CRA strives to improve the timeliness of all objections including objections concerning large case files. The Office of the Auditor General

has recently examined the issue of timeliness with regards to the resolution of objections. Recommendations from the OAG will be taken into account as we continue to identify further efficiencies and improve communications with taxpayers.

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c. *Audit & Rulings Resources*

The audit teams for a number of TEI members are now based in locations other than the location of the taxpayer's offices. In addition, Rulings officers who often support audit activities are no longer centralized in Ottawa but are situated in various locations across the country, often working remotely. TEI understands these changes have been made to make the most efficient use of limited resources and, particularly in the case of Rulings, access additional expertise. In some cases, however, it has been the experience of TEI members that "out-of-city" field auditors lack the industry-specific expertise or familiarity with the taxpayer's business to conduct focussed inquiries, resulting in an unfocussed approach to audits that is not efficient for the taxpayer or the CRA. We understand the CRA has a variety of programs, including on-line training, available to address this issue, and TEI commends the CRA for its efforts in this regard. Can the CRA provide an update on any further developments in these areas? In particular, can the CRA:

i. comment on whether any additional resources will be allocated to ensuring field auditors obtain sufficient expertise to conduct focussed and efficient audits; and

CRA Response – 1c(i):

The national workload allocation policy, and the Integrated Large Business Audit Team and the Large Business – Income Tax rotation policy were conceived by the CRA in an effort to focus technical capacity and resources on the highest risk taxpayers while ensuring quality, control, and integrity in the audit.

The CRA is implementing national systems, policies and procedures in support of national workload allocation based on risk, resources and technical capacity. This allows the CRA to leverage available resources nationally and encourage the transfer of commercial and industry knowledge between Tax Services Offices.

Integrated Large Business Audit Teams are comprised of domestic tax, international, and tax avoidance auditors. The implementation of these teams in April 2016 allows the CRA to:

- enhance its risk assessment and workload selection processes nationally;
- further enhance its compliance efforts on higher risk taxpayers;
- leverage technical capacity and commercial awareness across the country through workload portability;

- achieve audit currency for compliant taxpayers; and
- enhance audit quality, integrity and control.

The rotation of International and Large Business Case Managers (ILBCM) having sufficient industry knowledge ensures commercial awareness and continuity of compliance activities with more than one Case Manager knowing the taxpayer's business activities. Generally, rotation will occur every four taxation years under audit with an exception to the general policy in certain circumstances to preserve industry-specific knowledge on a particular case.

In addition, the CRA is implementing a new national audit case system that will facilitate the transfer of completed electronic audit files between rotating Case Managers and their auditors to increase knowledge transfer on the file and to improve internal controls within the audit function.

Along with these efforts to encourage knowledge transfer between auditors and regions, the CRA continues to build and maintain technical capacity within the large business audit program through formal technical training, informal information sessions, and communities of practice at the local level often facilitated by our subject matter experts in Income Tax Rulings, Industry Specialized Services, Legislative Application, International Tax Program and Abusive Tax Avoidance Program focusing on the most significant compliance issues. The CRA is increasing its use of innovative delivery methods to enhance the learning experience through on-line courses, webinars, job aids, and virtual round table discussions.

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ii. provide an update on CRA programs or initiatives to facilitate coordination between taxpayers, out-of-city auditors, and Rulings?

CRA Response – 1c(ii):

We want to start by first clarifying that, once under audit, a taxpayer has limited direct access to the Income Tax Rulings Directorate (Rulings). The taxpayer is encouraged to work directly with the auditor or the large case file manager during the audit process; however, Rulings will provide assistance to an auditor when requested.

To that end, we would like to highlight a few CRA initiatives that may be of interest that we feel help to facilitate coordination between Rulings and out-of-city auditors:

1. Building our technical capacity / Satellite offices

We take pride in our recent efforts to increase the technical capacity of Rulings across the country over the last four years. This strategic initiative has allowed us to make the most efficient use of limited resources and to gain access to specialized tax expertise in various cities across Canada.

Although Ottawa remains our headquarters location, we do intend to continue to build our strength and manage our talent using satellite offices in the Greater Toronto Area, Montreal, and hopefully over time, expand to include western Canada as well.

Our presence in these satellite offices has helped us to better serve our out-of-city auditors by creating a physical presence in these major cities. Rulings officers commit a minimum of one day each week to focus on providing support to auditors in the field.

2. MOUs

As you may know, in 2014 memorandums of understanding between both SMED (small and medium enterprise) and Rulings and ILBIB (international and large business investigations) and Rulings were developed to serve as a framework within which Rulings will endeavour to streamline the provision of internal support specific to the interpretation and application of the provisions of the Act and Regulations.

Specifically, the main objectives of this formalized internal process are to:

a. ensure timely and appropriate attention to the technical interpretation and application queries received from our auditors, and

b. promote consistency, while preventing duplication and gaps in the provision of technical advice to the field.

This initiative is part of a continued effort to enhance communication between headquarters and the field offices with respect to interpretation and application of the provisions of the Act and Regulations.

3. NTCBFs

We would also like to take this opportunity to update you on our continued efforts with a more formal internal training process we refer to as our National Technical Capacity Building Forums (the Forums).

The Forum objective is to better disseminate technical positions to various areas within the CRA and to allow subject matter experts from within our directorate to communicate complex technical positions and interpretative issues related to the provisions of the Act and the Regulations to CRA employees through our web-based platform.

Rulings is pleased to report the first four years of this program have been quite successful – Forum participation has increased steadily across the Agency and across the various regions, reaching a total of 14,500 participants for 2016 (which has doubled since its inception in 2013).

Question 2. *CRA Online Account*

a. General Update on My Business Account

The CRA continues to introduce new features to the online My Business Account system, making the system increasingly useful for taxpayers. TEI invites a discussion on the new features recently added to My Business Account and the CRA's upcoming plans for features to be added that will be of benefit to large corporate taxpayers.

CRA Response – 2a:

The following services were recently added to My Business Account:

- Business owners are able to file original, amended, and cancelled T3 Specials for any tax year through "Internet file transfer."

- Payroll accounts: New filing requirements for payroll accounts are live

    - New employers are now eligible for quarterly remitting if they have monthly withholding of less than $1,000 and maintain a perfect compliance record in respect of their Canadian tax obligations. This measure will not affect the amount of tax owing, just the timing of the payments. This amount of withholdings corresponds to the withholdings related to one employee at a salary of up to $43,500, depending on the province of residence.

- My Audit Enquiries- A new service located on the left hand menu, allows business to submit an Audit enquiry and view their Audit enquiry history. It also enables two-way secure electronic document communication between an auditor/compliance program officer and the taxpayer and/or their authorized representative to send/receive documentation as well as allowing an auditor to initiate the enquiry. My Audit also enables the taxpayer and/or their authorized representative to submit electronic enquiries associated with their case under audit for multiple responses from the auditor/compliance program officer

- Submit Documents: Business Owners or their authorized representatives can now submit documents both by request from the CRA and voluntarily. Some of the documents that can be voluntarily submitted include but are not limited to:

    - Form CPT1 or documents supporting a CPP/EI Ruling Request

    - CPP certificate of coverage documents

    - Submit a GST/HST Ruling request or supporting documentation

- Form RC4288 or supporting documents to request to cancel or waive penalties or interest

- Our look: With the implementation of WET 4.0, My Business Account has a different look in order to observe the guidelines that have been set by the Government of Canada to deliver websites and applications that are more accessible, usable and optimized for mobile devices.

As of mid-May 2017, the CRA is planning on enhancing My Business Account (MyBA) to post the following:

(1) Capital Dividend Account (CDA) balances that have been verified by the CRA;

(2) Assessed values for T2 returns and schedules - Corporations will be able to view the assessed values of their T2 returns and schedules on MyBA. We are also going to make this data available through T2 tax preparation software in the future (target fall 2017). The mechanism used will be similar to T1's Autofill My Return service, where the user would authenticate themselves through certified tax preparation software using their My Business Account credentials, and download the assessed values for a given tax-year-end directly into their T2 tax preparation software.

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b. Corporate Taxpayer Representative Authorizations

The addition of the "GroupID" feature in CRA's Online My Business Account system has been a very effective tool for allowing businesses to add and remove new representatives quickly. When authorized employees are listed as members of the GroupID, they can access the online information they require. However they are frequently not able to get the same information or other information over the phone even though the addition of a GroupID on the RC59 form states that the authorization for the online access also includes telephone, fax, and mail. The reason for this seems to be that in some cases CRA's representatives cannot see the list of members that are part of the GroupID. Would the CRA consider making available the GroupID's members to its representatives? Does authorizing an employee as a "Senior Representative" using the Group ID feature provide the employee with the same level of authorization as a Level 2 on Form RC59?

CRA Response – 2b:

Thank you for bringing this to our attention. We are pleased that the GroupID addition is well received and functioning to meet your needs. The CRA will look into the feasibility of making the GroupID's members available to all service providers.

The levels of authorization found on the RC59 indicates what the Client (Taxpayer) will allow their representative to do on their behalf.

Level 1 will allow the rep to "view" items online or ask questions of the Agency either by phone or by mail. Level 2 authorization allows the rep to also request changes on behalf of their client.

When assigning roles to a representative, we allow the employer to decide what they want their employees to be able to do on behalf of their company for their tax client.

A junior rep will be allowed to view only regardless of a level 1 or level 2 on the RC59. A Senior Rep is allowed to view and perform changes on behalf of their employer's tax client, so long as a level 2 RC59 authorization exists.

A Senior Rep cannot do more then what the RC59 will allow. So while it would appear the Senior Representatives rights are the same as signing a level 2 on an RC59, there are some differences.

Question 3. *Collections Matters*

Income tax assessments issued to large corporate taxpayers immediately trigger payment obligations, even when the taxpayer is formally disputing the assessed amounts. This includes non-resident withholding tax and penalty assessments. Because disputes can take years to resolve, taxpayers may prefer to post security instead of paying cash. Some provinces will accept surety bonds for provincial tax obligations, and the CRA accepts surety bonds for non-income tax obligations. In contrast, the CRA has a practice of accepting letters of security from accepted Canadian institutions as security but does not appear to accept surety bonds for income tax obligations. Why does CRA accept letters of credits as security but not surety bonds?

CRA Response:

Pursuant to subsection 220(4) of the *Income Tax Act* (the "*Act*"), the Minister may, if the Minister considers it advisable in a particular case, accept security for payment of any amount that is or may become payable under the *Act*. Short of cash, Standby Letters of Credit or Bank Letters of Guarantee provided by a Schedule I Canadian bank are preferred, as these types of security are liquid, equivalent to cash, and exercisable upon demand without defence or counterclaim. Surety bonds, in general, do not exhibit similar features. However, if a form of security is being proposed, the Minister will review the proposed security during the course of administering the *Act*, and determine whether it is advisable to accept the proposed security.

D. Audit/Appeal Matters

Question 1. *Bifurcation of Issues for Court Appeal*

The intent of subsection 171(2), regarding partial disposition of appeal, is to reduce the Tax Court of Canada's caseload and allow independent disposal of some issues. We understand that some taxpayers have experienced denials of bifurcation requests under

subsection 171(2) and that the Department of Justice may be averse to the bifurcation of appeals issues.

TEI believes bifurcation is an important tool for improving the Tax Court's caseload management and that failure to bifurcate could have an adverse effect on a taxpayer who has requested such bifurcation. For example, a taxpayer may be reassessed on an issue within the normal reassessment period and file a notice of appeal in the Tax Court. The CRA may subsequently audit the taxpayer on transfer-pricing issues for the same taxation year under the extended reassessment period and issue a subsequent reassessment. The second reassessment would invalidate the litigation unless the notice of appeal is amended to include the new reassessment.

The taxpayer may want to use the competent authority procedure to resolve the transfer pricing matter, while continuing to litigate the original issue in Tax Court. IC 71-175R5, "Guidance on Competent Authority Assistance Under Canada's Tax Conventions" states that if a taxpayer proceeds with an appeal to a Canadian court on a matter under competent authority consideration, the competent authority process will be terminated unless the appeal is held in abeyance. It would be beneficial for the taxpayer to bifurcate the transfer pricing issue from the original issue in this circumstance so that the transfer-pricing matter can be resolved by competent authority and the Tax Court litigation on the original issue can separately continue.

We believe that a refusal by the DOJ to bifurcate may impose undue time and cost on the Tax Court, the DOJ, and the taxpayer associated with a court appeal for all issues in a tax year. (a) Are there guidelines that the CRA uses to provide recommendations to the DOJ as to when consent should or should not be provided to bifurcation of appeal issues in a tax year? (b) Can the CRA comment on the circumstances when it would recommend not consenting to bifurcation of appeal issues if bifurcation is requested by a taxpayer? (c) If the DOJ also has input into the decision of the CRA's counsel on bifurcation, can the CRA comment on the input and guidance received from the DOJ with respect to bifurcation requests? (d) Finally, can the CRA comment on the example set out above, where bifurcation would allow a taxpayer to use the competent authority procedure if an unrelated issue is already in Tax Court for the same tax year?

CRA Response:

(a) The CRA has not developed specific guidelines with respect to the application of subsection 171(2) of the Act. Cases are reviewed individually and a decision as to whether consent will be granted is made in consultation with the DOJ lawyers assigned to the cases.

(b) The merits of bifurcation are considered in consultation with the DOJ based on the particular circumstances of each case. As all cases are different the CRA is not prepared to give examples of circumstances in which the CRA would consent to bifurcation of an appeal. However, it should be noted that the CRA has and will continue to agree to bifurcation in circumstances where the CRA deems it appropriate to do so.

(c) It should be noted that the DOJ and the CRA's counsel are one in the same. The CRA and the DOJ counsel jointly discuss the merits of consenting to bifurcation and a decision is based on a consideration of whether bifurcation is in the best interests of both the DOJ and the CRA, taking into account the proper resolution of the issues efficiently. While there may be circumstances in which bifurcation can save time and effort for the Tax Court and the parties involved, bifurcation can also result in duplication of effort should the CRA and DOJ have to litigate two separate cases instead of one.

(d) The example provided is not detailed enough to determine whether the CRA would consent to bifurcation. The Competent Authority process will not always resolve an issue, for example, where a taxpayer disagrees with the outcome of the Competent Authority process the taxpayer has the right to refuse the outcome and proceed to court, resulting in the CRA and the DOJ having to litigate two separate cases.

Question 2. *Audit Approach*

To exercise its role with respect to the administration and enforcement of the Income Tax Act, the CRA has been granted powers to access taxpayer's information. Section 231.1 permits the CRA to inspect, audit, or examine the books of a taxpayer and entitles auditors to request and examine documents, including computer records. Section 231.2 entitles CRA to issue a request for information, which is a more formal procedure, whereby a formal "demand" or "requirement" is issued. Generally, it is our understanding that the case law suggests that section 231.2 is not to be used where section 231.1 is sufficient. If a taxpayer does not provide access to the information, the Minister can seek a court order for compliance under section 231.7. The powers of the CRA under section 231.1 of the Act are very broad and permit the auditors to access any document "that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under the Act."

Section 10.8.3 and following of the CRA Audit Manual provide guidance as to how the CRA should approach a request for information and documents. Generally, the objective is to obtain the evidence necessary to adequately evaluate the matter at issue without requesting too much documentation, using professional judgment and reasonableness, considering the circumstances. Reasonable time should be given in order to comply, normally 30 days. Before issuing a requirement as a result of significant non-compliance with an information request, the CRA must demonstrate that all actions have been taken to achieve compliance and indicate the responses or actions of the non-compliant taxpayer.

TEI understands that the CRA encourages open communication with taxpayers in connection with requests for information and documents, and this has been the experience of many TEI members. In those cases, the audit team discusses the scope of the audit openly and would agree with the taxpayer on the amount and timing of the information to be provided. However, some TEI members have experienced a more rigid and formal approach to requests for information, with deadlines that are not realistic under the circumstances. In these cases, the

auditors have also inserted a statement in the request that if the deadline is not respected, procedures under section 231.2 will be taken. TEI is of the view that this approach not only causes unnecessary and undue strain on the taxpayer's resources but is also detrimental to the CRA in that it results in adversarial discussions and increased administrative procedures, which are counterproductive to the CRA's efforts to become current in audits.

Could the CRA confirm TEI's understanding that requests for information should be based on open dialogue and follow a reasonable approach, considering the circumstances? Could the CRA comment on the procedures that must be followed prior to issuing formal and rigid requests for information referring to section 231.2? What actions are taken to ensure consistency in the approach between different audit teams and TSO?

CRA Response:

The CRA has several legislative information gathering tools that enable an official to request or require information for verification and administrative purposes. Application of the appropriate tool is the responsibility of the official and will be and will be carried out based on the facts of each case. An official's use of any one of these complementary information gathering provisions is discretionary, allowing the official to use the most effective means available to secure the information needed.

Any request from the CRA under the ITA is a formal request, whether it is pursuant to section 231.1 or section 231.2.

Generally the CRA uses these provisions for different circumstances, taking into consideration any relevant case law.

The CRA may request, under section 231.1 of the ITA, information that should be in the books and records from a taxpayer, or any other person who has such information, as long as the request is made in the context of an audit.

An official may issue a requirement under subsection 231.2(1) of the ITA for any information or additional information and for any document, for any purpose related to the administration and enforcement of the legislation. This provision can also be used to request information from third parties not under audit.

Taxpayers must be given a reasonable time to provide the requested information. Jurisprudence has confirmed that 30 days is considered a reasonable period of time. Other time frames may be considered reasonable given the scope of the information requested or the circumstances of the particular situation.

Traditionally, when information was not provided pursuant to a request made under section 231.1 of the ITA, an official would have considered using a requirement under section 231.2 of the ITA to obtain the information or documents that had not been voluntarily provided during the course of an audit.

The CRA now recommends that an official should consider seeking a compliance order under section 231.7 of the ITA when the information has not been provided pursuant to a request under section 231.1. The CRA also recommends that an official should consider seeking a compliance order under section 231.7 of the ITA when the information requested has not been provided pursuant to a request under section 231.2.

The CRA has several policies concerning the application of these legislative tools to encourage consistency in the approaches taken by different audits teams and TSOs.

Question 3. *Gross Negligence Penalties*

The Act contains a number of provisions that permit the application of penalties if a taxpayer has made an omission on a return in circumstances amounting to gross negligence. It is clear from the case law that a high standard must be met in order for a gross negligence penalty to stand: "[g]ross negligence must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not." *Venne v. The Queen*, [1984] CTC 223 at 234 (FCTD).

Some TEI members have recently experienced an increase in field auditors proposing to levy gross negligence penalties. It appears that such penalties may be applied by field auditors in circumstances that do not reach the threshold set out in the case law or the guidance issued by the CRA in its audit manual for the application of such penalties. For example, in one instance a field auditor proposed to levy a gross negligence penalty because an amount was inadvertently underreported on an information return in circumstances where the taxpayer promptly brought the omission to the CRA's attention. No taxes were owing as a result of the omission on the information return. In another instance, an accounting error was made by a taxpayer, and the field auditor advised that the error would need to be reviewed by Head Office to determine if gross negligence penalties should be applied. In both of these instances our members had to allocate significant resources to defending against the proposed application of the penalties.

Our members take their compliance obligations very seriously and are committed to ensuring proper compliance. Therefore, the proposed application of gross negligence penalties is always of concern.

Could the CRA confirm TEI's understanding that gross negligence penalties should not be applied solely because a taxpayer made a mistake or took a filing position that differs from CRA's view on the interpretation of the Income Tax Act or the Regulations? Could the CRA comment on the procedures that must be followed to assess whether gross negligence penalties should be levied, what level of approval is required at the TSO and Head Office, and in what circumstances an assessment of gross negligence penalties is required? Could the CRA provide examples of situations where they consider gross negligence penalties appropriate? What actions are taken to ensure consistency in the approach between different audit teams and TSO?

CRA Response:

As part of the comments provided by the TEI to this question, some members expressed their experiences with their clients. As we do not have details on their specific matters, we cannot comment on them here.

However, generally, subsection 163(2) allows the application of a penalty, commonly referred to as "gross negligence penalties," if a person or partnership "knowingly or under circumstances amounting to gross negligence" makes or is otherwise involved in the making of "a false statement or omission" in a return or in giving information.

1) Could the CRA confirm TEI's understanding that gross negligence penalties should not be applied solely because a taxpayer made a mistake or took a filing position that differs from CRA's view on the interpretation of the Income Tax Act or the Regulations?

Generally, a penalty would not be imposed if there is a possibility of honest misinterpretation of the law by the taxpayer or genuine confusion as to whether an amount not reported was really taxable.

2) Could the CRA comment on the procedures that must be followed to assess whether gross negligence penalties should be levied, what level of approval is required at the TSO and Head office, and in what circumstances an assessment of gross negligence penalties is required?

Auditors are required to prepare a Penalty Recommendation Report. The report is a complete summary of the facts and all statements supported by the working papers and other documents on file. It is a self-contained report enabling the reader to act on the auditor's recommendation without reference to other working papers.

This report and the auditor's working papers are to be in sufficient detail to ensure that the penalty has been properly applied and that if appealed, the auditor will be able to recall and identify documents and offer testimony about the records examined and the audit evidence uncovered justifying the imposition of a penalty.

Gross negligence penalties apply where a person or partnership "knowingly or under circumstances amounting to gross negligence" makes or is otherwise involved in the making of "a false statement or omission" in a return or in giving information.

The term "knowingly" implies that a taxpayer knew or ought to have known that the amount of tax paid was less than should otherwise have been paid for the purposes of the ITA or that the amount of refund or rebate claimed was greater than the amount that the person was eligible to receive for the purposes of the ITA. The term "knew" implies that a taxpayer deliberately or intentionally acted in such a manner, while the expression "ought to have known" does not mean actual knowledge, but means that the taxpayer had in effect the means of knowledge.

Lastly, the expression "gross negligence" covers a set of facts which clearly shows either that the taxpayer knew or ought to have known that an offence was committed or that the taxpayer acted so carelessly or so negligently that the way in which the taxpayer handled their affairs amounted to gross negligence.

Penalty Recommendation Reports are approved by the assistant director of Audit (ADA), or by the delegated signing authority.

3) Could the CRA provide examples of situations where they consider gross negligence penalties appropriate?

Generally to determine if gross negligence penalties should be applied, the CRA would consider (not an exhaustive list):

- materiality of the false statement or omission;
- taxpayer's knowledge of tax matters;
- nature of the false statement or omission;
- taxpayer's involvement in preparing the return; or,
- taxpayer's history of compliance.

Examples:

Net worth assessment

The CRA would consider assessing penalties in all cases where the assessing net worth technique, used as the main audit technique, reveals a substantial discrepancy in the taxpayer's income.

Suppressed income of a corporation appropriated by shareholders

If income of a corporation has been suppressed and a shareholder has used or has benefited from the funds or property that would otherwise have been received by the corporation, the CRA would consider applying penalties against both the corporation and the shareholder for each tax year involved.

Overstatement of tax credits

A penalty can be assessed on the overstatement of tax credits such as;

- GST credit
- Refundable investment tax credit
- Canadian film or video production tax credit

- Film or video production services tax credit

4) What actions are taken to ensure consistency in the approach between different audit teams and TSO?

TSOs are provided with instructions on what factors to consider for the imposition of a gross negligence penalty under subsection 163(2). This ensures consistency between TSOs.

As mentioned above, each time gross negligence penalties are considered, auditors are required to prepare a detailed penalty recommendation report, which is reviewed by their team leader and approved by the assistant director of Audit for the TSO or by the delegated signing authority. This ensures consistency between audit teams at the TSO.

Question 4. *Assessment Procedure Under the General Anti-Avoidance Rule*

Our understanding is that the GAAR Committee must approve any reassessment invoking the general anti-avoidance rule ("GAAR") under section 245 prior to such reassessment being made. However, it appears that TEI members have had different experiences in terms of matters going before the GAAR Committee. In some cases a matter has gone to the GAAR Committee prior to the taxpayer receiving a proposal letter regarding a proposed assessment. In other cases some TEI members have been reassessed under GAAR without the GAAR Committee first having reviewed the matter, contrary to our understanding set out above. Large taxpayers would appreciate greater transparency as to how the GAAR Committee operates from a procedural perspective. Can the CRA comment on what procedures must be followed before a taxpayer can be reassessed under GAAR? Specifically:

a. Can a GAAR reassessment be made if a matter has not gone before the GAAR committee?

b. If the response to (a) is yes, can the reassessment only be made if a similar matter has gone before the GAAR Committee, or can the CRA reassess under GAAR without ever having taken the matter to the GAAR Committee?

c. Do the answers to (a) or (b) change if GAAR is the secondary, as opposed to the primary, assessing position?

d. Do taxpayers have to be informed prior to a matter being referred to the GAAR Committee so that they have the ability to make representations to the GAAR Committee?

e. Can the CRA comment on the composition of the GAAR committee? Specifically, how many individuals from the CRA, the Department of Finance, and the DOJ sit on the GAAR Committee, how often are the positions rotated, and does membership change based on the topic before the committee?

f. Can the CRA comment on the process followed for GAAR Committee referrals at the proposed assessment stage? Our understanding is that the process is generally as follows:

   i. TSO refers the matter to TSO Aggressive Tax Planning ("ATP"),

   ii. If TSO-ATP determines that the proposed assessment should move forward, the matter then gets referred to the HQ-ATP.

   iii. HQ-ATP determines whether the matter should be referred to the GAAR Committee.

   iv. GAAR Committee referral.

Can the CRA comment on whether this is correct?

CRA Response:

Background

The GAAR Committee was established to provide advice on the application of the GAAR in the Income Tax Act (Canada) and the Excise Tax Act, to ensure that the GAAR is applied consistently. The role of the GAAR Committee is to provide recommendations in respect of the application of GAAR to: (i) proposed transactions for which advance income tax rulings are requested, and (ii) transactions under review by audit.

GAAR Committee Composition

Historically, the Chair and co-secretaries have always been from the Income Tax Rulings Directorate (CRA). They organize, coordinate and facilitate all meetings. The directors of all four divisions within the Income Tax Rulings Directorate are invited to and usually attend all GAAR Committee meetings.

The GAAR Committee is an Ad Hoc committee composed of representatives from: (i) the Income Tax Rulings Directorate (CRA); (ii) the Legislative Policy Directorate (CRA); (iii) the Abusive Tax Avoidance and Technical Support Division of the International and Large Business Directorate (CRA); (iv) the Department of Finance; (v) the Department of Justice; (vi) Legal Services (a group from the Department of Justice dedicated to providing the CRA with legal support). Although some representatives attend all meetings, others vary depending on the subject matter being discussed at the meeting.

Audit/GAAR Reassessment Process

The audit process for GAAR issues is essentially the same as the process for any audit issue, except that advice is obtained from the Abusive Tax Avoidance and Technical Support Division

in Headquarters ("Headquarters") and, where applicable as described below, the GAAR Committee. Headquarters' role is to review files where a Tax Service Office ("TSO") is considering the application of the GAAR as a primary or alternative assessing position.

The stage at which the TSO sends a proposal letter to a taxpayer on a file involving the GAAR depends on the circumstances.

The TSO will generally review the particular facts of each file to establish the purpose of the transactions and determine if any of the transactions is an avoidance transaction. Where the transactions under audit are similar to situations previously considered by the GAAR Committee and resulted in a recommendation to apply GAAR, generally the TSO will proceed with the proposal letter and obtain the taxpayer's representations. The TSO will subsequently refer the matter to Headquarters with the taxpayer's representations (if any), to obtain its recommendation.

Where the TSO reviews the particular facts of a file and determines that the matter has not been previously considered by the GAAR Committee, and the GAAR is likely the primary position, the TSO will refer the matter to Headquarters prior to the issuance of a proposal letter. In this circumstance, the TSO will generally only proceed with the issuance of a proposal letter if it obtains the recommendation of Headquarters on the application of the GAAR. Headquarters will generally in turn refer the matter to the GAAR Committee for consideration.

Headquarters might sometimes recommend not to proceed with a GAAR reassessment without consulting with the GAAR Committee in circumstances where Headquarters believes that there are no grounds to consider the application of the GAAR. However, Headquarters may still submit the case to the GAAR Committee to obtain their recommendation.

Any submission received from the taxpayer or the taxpayer's representatives are forwarded, in their entirety, to Headquarters and, where applicable, the GAAR Committee. Thus taxpayers should be assured that when the application of the GAAR is considered, all their arguments will have received careful consideration.

Question 5. *Transfer-Pricing Penalties*

In today's business environment, corporations take their legal and regulatory compliance obligations very seriously and have robust programs in place to ensure compliance is a priority throughout the organization. In this environment, penalties in particular are heavily scrutinized, and organizations are expected to take action to ensure that, to the greatest extent possible, penalties are avoided and do not recur. As a result, when penalties are assessed it is important for taxpayers to gain an understanding of the bases for the penalties so that the taxpayers can ensure compliance going forward. In this respect, TEI invites a discussion on responses provided by the Transfer Pricing Review Committee ("TPRC") in situations when penalties under 247(3) are applied.

As background, the TPRC reviews all transfer pricing adjustments in excess of 10 percent of gross revenue or $5,000,000 to determine if penalties should be applied under subsection 247(3). As explained in CRA's TPM-09, in determining whether the transfer pricing penalty is applicable, it is necessary for the taxpayer to show it made reasonable efforts both in establishing and using arm's length pricing. The general determination of whether a taxpayer has made reasonable efforts to determine and use arm's length transfer prices or allocations is a question of fact. Clearly this determination is not easy or straight-forward. Unfortunately, the TPRC typically provides a very brief response when it decides to apply penalties under subsection 247(3). Therefore it is very difficult for taxpayers to fully understand the bases upon which the TPRC concluded the taxpayer's documentation did not meet the required standard. As a result, it is difficult for taxpayers to ensure they have corrected the deficiency going forward. Would the CRA consider providing a more detailed response in situations where penalties under subsection 247(3) are asserted?

CRA Response:

Under the existing procedures, the taxpayer is provided with a copy of the final penalty referral report submitted to the Transfer Pricing Review Committee. As such, the taxpayer has access to the facts that were presented to the Committee with respect to any general determination of reasonable efforts set forth in subsection 247(3). When the Committee renders a decision based on a factual analysis of subsection 247(3), the major points of contention are outlined in the letter that the Committee provides to the Tax Services Office with the results of the decision.

When penalties are determined under the deeming provision in paragraph 247(4)(a), the Committee clearly indicates which of subparagraphs (i) – (vi) were not met.

We, therefore, consider that sufficient detail regarding the Committee's decision is already being provided.

Question 6. *"Bucket" Approach to Audits*

Personnel for the CRA's Competent Authority Services Division stated on August 30, 2016 at a transfer-pricing conference in Toronto that the CRA and the U.S. Internal Revenue Service ("IRS") "are in preliminary, informal discussions" about the possibility of expanding a joint audit program employing a "bucket" approach to audits. What is meant by a "bucket" approach and what are the circumstances under which the CRA and the IRS might jointly audit a Canadian corporate taxpayer? What are the possibilities of this program becoming a reality and when might it begin on a regular basis? Is the CRA considering the possibility of corporate taxpayers being able to request such joints audit when already being audited in both Canada and the United States?

CRA Response:

Canada has regular exchanges with other countries to share information about emerging issues and to identify opportunities to conduct simultaneous risk assessment and joint audit initiatives. These interactions are meant to inform case selection and expedite the resolution of double tax issues. This is not a separate program. The CRA is considering opportunities for bilateral or multilateral compliance activities in the appropriate circumstances. While the CRA is developing a strategy around mutual compliance activities, it does not have a formal mechanism for taxpayers to make such requests. However, we are open to hearing the views of taxpayers in this regard.

E. Technical Matters

Question 1. *Country-by-Country Reporting*

Now that the Department of Finance has released proposed legislation implementing country-by-country reporting in Canada, can the CRA comment on whether any efforts will be made to streamline some of the related-information reporting forms, such as T106s and T1134s? If so, who will be part of the process to streamline?

CRA Response:

At this time, the CRA does not expect to change the information requirements in the returns related to the reporting of income from Canadian controlled and non-controlled foreign affiliates (Form T1134) and the reporting of non-arm's length transactions with non-residents (Form T106). The taxpayers required to file CbC Reports versus T1134s and T106s are overlapping but not identical. In general terms, the existing requirements of the T106 and T1134 forms are more detailed than the CbC Reports. The CbC Reports offer benefits of higher level information and uniformity of reporting across jurisdictions. Going forward, as CRA gains experience with increased electronic data sources and filing requirements, consideration could be given to conducting a review to reduce or eliminate overlap and duplication, where possible.

Question 2. *Benefits and Allowances Received from Employment*

On July 6, 2016 the CRA published a new Income Tax Folio Chapter S2-F3-C2 *Benefits and Allowances Received from Employment.* While it appears that this chapter is intended to be a consolidation and restatement of former publications and previously communicated positions, there seem to be some inconsistencies and changes in positions. In particular, TEI has identified the following four items that we request the CRA consider and address in an update to this chapter.

a. Primary Beneficiary: "Incentive" Trips (Paragraph 2.25)

Paragraph 2.25 states that the employer is the primary beneficiary of employee trips that are taken for "employment-related reasons" where the employee is engaged directly in employment activities during a substantial part of each day. The next sentence states that where an employee receives a trip as an "incentive or award," the employee is the primary beneficiary of the trip. These two sentences imply a dichotomy where "incentive trips" and "employment-related" trips are mutually exclusive categories. This is in contrast to earlier CRA positions such as CRA Views Document 9905737 in which the CRA stated, "[I]n each case, whether the trip given to the employee by the employer is in respect of a convention, conference, or *incentive award trip*, the business aspect or the personal benefit must be identified and measured with some reasonableness." (emphasis added)

Trips offered by employers to high-performing employees might be considered "incentives" from the employees' perspectives but may serve valuable primary business purposes from the employers' perspectives. For example, gatherings of high-performing employees may provide valuable networking and educational opportunities, particularly in the context of business sessions or other business-related events that may take up a substantial part of each day. We believe that such a trip consisting of a group of employees participating in a company structured program is distinguishable from a vacation given to an employee to enjoy at his or her leisure. The business is the primary beneficiary of the former whereas the employee is the primary beneficiary of the latter.

Would the CRA be willing to amend paragraph 2.25 to account for trips that may be viewed by employees as "incentives" but serve a primary business purpose for the employer? Such amendment would be consistent with prior CRA positions and case law, including *Lowe v. The Queen*, [96] D.T.C. 6226 ("However, where an employee receives a trip as an employment incentive or award *and is not engaged in employment/business activities during a substantial part of each day of the trip*, the employee is the primary beneficiary….") (emphasis added).

CRA Response – 2a:

Paragraph 2.25 does recognize that employment-related activities may be part of an incentive or award trip. The last sentence of paragraph 2.25 states, "If the employee is required to perform employment duties during that trip, any benefit included in the employee's income may be reduced for any actual employment-related activity." In your example, if a sales team is awarded a trip for achieving a set target, and they are required to perform employment duties while on the trip, then the benefit may be reduced to the extent of the employment-related activities.

b. Economic Advantage: Reimbursements (Paragraph 2.16)

Paragraph 2.16 states that "a reimbursement is a payment (…) for which detailed receipts are provided." "Detailed receipts" are not mentioned in Guide T4130, which states more generally that "[t]he employee has to keep *proper records* to support the expenses and give them to the employer." (emphasis added). Paragraph 2.16 therefore appears to reflect a change in position where the CRA now specifically expects employees to provide detailed receipts. However, the next sentence in paragraph 2.16 states that the employee is required to submit receipts "or" show the employer how the amount was spent.

Would the CRA be willing to amend paragraph 2.16 to clarify whether "detailed receipts" are always required? If detailed receipts are not always required, would the CRA consider changing the first sentence of paragraph 2.16 to read as follows, so that it is consistent with Guide T4130?: "A reimbursement is a payment made to repay an amount an employee spent on a specific expense and for which *proper records are provided to the employer*. When an employee is required to submit receipts or *otherwise* show the employer how the amount was spent…."

CRA Response – 2b:

The definition of reimbursement is consistent with *Verdun v The Queen*, 98 DTC 6175, which states, "Even when these amounts are not used for any improper purpose, and even when they are reasonable estimations of the costs, our law treats them as additional remuneration, not as reimbursement of expenses, which require detailed receipts being submitted for reimbursement."

In most cases, the best evidence to show how much was spent is the actual receipt (for example, an invoice). The reference in Guide T4130 to "proper records" could include a copy of the invoice.

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c. Third-Party Benefits: Reporting (Paragraphs 2.27-2.28)

Paragraphs 2.27 and 2.28 and their corresponding examples describe situations where an employee must include in income the value of a benefit provided by somebody other than the employer. Paragraph 2.69 states that, generally, benefits included in an employee's income must be reported and subject to income-tax withholding. However, the chapter remains silent on whether the third-party benefit is to be reported by the employer, a third party, or self-reported by the employee for benefits. For example, CRA Views Document 2010-0388581E5 states that gifts from customers are subject to income tax, but does not comment on either the employer's or the customer's reporting obligations. In other documents, the CRA's position appears to be, consistent with section 153, that the person paying the benefit is responsible for

the reporting. For example, the CRA's policy on "Awards from a Manufacturer" states that if a manufacturer gives a cash or non-cash award directly to the employee of a dealer, the manufacturer has to report the value of the award on a T4A. Similarly, in CRA Views Document 2011-0401781E5, the CRA stated that the reporting of a settlement of union grievances must be done by the entity that distributes the settlement, either the employer or the union. There are also situations, such as with loyalty points for credit-card expenses, where it is the employee's responsibility to self-report the fair-market value of the personal rewards received.

Can the CRA comment on whether it would be willing to amend paragraphs 2.27 and 2.28 to clarify which party has the reporting responsibility for third-party benefits. For example, the guidance could state: "This means that a benefit may be included in an employee's income even if the benefit is not provided by the employer. The obligation to report and/or withhold on the value of the benefit (see paragraph 2.69) is the responsibility of the person who has custody and control over which individual the benefit will be provided to, which custody and control may be had in either the employer or the third party depending on the circumstances."

Taxpayers can experience significant compliance burdens in situations in which a third-party payer must report a payment issued to a non-employee. Because there is no existing employer/employee relationship, the payer typically does not have the required information on hand, such as SIN and home address, and the required slips are incremental reporting. Given the compliance burden associated with third-party benefit reporting, would the CRA consider extending the same $500 reporting threshold that exists for non-cash gifts and awards received from an employer to benefits received from third parties?

CRA Response – 2c:

Paragraph 2.69 discusses reporting and withholding requirements for all benefits and allowances received from employment. The folio does not provide details on the reporting requirements for either the T4 or the T4A. However, the paragraph does provide a link to the CRA webpage, T4A – Information for payers. A link to Guide RC4157, Deducting Income Tax on Pension and Other Income, and Filing the T4A Slip and Summary, is provided on that webpage. Guide RC4157 has a section on benefits from a third party. We will consider adding a link to RC4157 to paragraph 2.69.

The $500 reporting threshold that exists for non-cash gifts and awards received from an employer will not be extended to benefits received from third parties. However, the CRA has another administrative policy that could apply to relieve the reporting burden of third-party providers. If the amount of the payment is $500 or less, CRA generally waives the T4A reporting requirement unless income tax was withheld at source, in which case a T4A must be issued. This policy does not apply to group term life insurance benefits. Those benefits must be reported on a T4A regardless of the amount.

d. Value of a Benefit: Intangibles (Paragraph 2.26)

Paragraph 2.26 defines "fair market value" and states that the fair market value of the benefit is to be included in the employee's income. Past CRA positions, such as CRA Views Document 2010-0377261E5, have discussed items where the fair market value cannot be determined. That document states, "Where the fair market value cannot be determined with any degree of certainty, it may be reasonable to consider the employer's cost as a measure of the benefit. However, the employer's cost is not necessarily indicative of the value of the benefit and generally should only be used where the value of the benefit to the employee cannot otherwise be determined." Registered Charities Newsletter 17 provided an example of something that cannot be valued, in the context of split receipting, which stated: "For example, a dinner with a celebrity cannot reasonably be valued."

Can the CRA comment on whether it would be willing to amend paragraph 2.26 to include a version of the position in CRA Views Document 2010-0377261E5. For example: "The fair market value (…) is the amount included in the employee's income under paragraph 6(1)(a). Where the fair market value cannot be determined with any degree of certainty, it may be reasonable to consider the employer's cost as a measure of the benefit."

CRA Response – 2d:

Paragraph 2.26 will be revised to better reflect the Federal Court of Appeal's decision in *The Queen v Carroll A. Spence*, 2011 FCA 200. In that case, the Federal Court of Appeal confirmed that the value of a benefit for purposes of paragraph 6(1)(a) is the fair market value, that is, the amount that the employee would have had to pay for the same benefit if there was no employer-employee relationship. The FCA also noted that "costs of the benefit to the employer is the wrong instrument to assess the value of the benefit. While in some cases … the cost may correspond to the fair market value, it is not necessarily the case."

The FCA case is dated June 13, 2011, almost nine months after 2010-0377261E5 was published. The comments in the folio are consistent with those in Guide T4130.