TAX EXECUTIVES INSTITUTE, INC.

INCOME TAX QUESTIONS

Submitted to

CANADA REVENUE AGENCY

DECEMBER 4, 2018

Tax Executives Institute Inc. ("TEI") welcomes the opportunity to present the following questions and comments on income tax issues, which will be discussed with representatives of the Canada Revenue Agency ("CRA") during our liaison meeting on December 4, 2018. Should you have any questions about the agenda in advance of the meeting, please do not hesitate to contact Brian Mustard, TEI's Vice President for Canadian Affairs, at (514) 870-1331, or Carolyn Mulder, Chair of TEI's Canadian Income Tax Committee, at (905) 821-2111, extension 78046.

A. Introductory Question

Technology is front and centre in the current environment. TEI is interested to understand how the CRA is currently using technology to improve its processes, and how the CRA envisions technology impacting income tax audits over the next three to five years. We would also appreciate the CRA's thoughts regarding the involvement of large business taxpayers in its technological development, and the role that TEI can play in helping the CRA achieve its technology development goals.

CRA RESPONSE

Service Technology for Large Business Taxpayers

CRA currently provides several types of service technology for Large Business Taxpayers:

- **Online mail** is an e-mail service whereby the CRA will send individuals, businesses and representatives an e-mail notification when there is mail for the client to view within their secure online portal. This service is available in My Account, My Business Account or Represent a Client and over 33 million pieces of correspondence have been issued to both individuals and businesses in this service;

- **Submit documents** allows individuals, businesses and representatives to send certain documents to the CRA electronically and securely. Once documents have been submitted, a confirmation number and a reference number are provided for

future communications with the CRA. Users can submit documents that have been requested by the CRA that have a related case number or they may submit documents on a voluntary basis by uploading and selecting the reason for their submission on the pick list. This service is available in Represent a Client, the secure portal for tax representatives (and also in My Account, My Business Account);

- **Audit Enquiries** service both My Account and My Business Account, where auditors and taxpayers can send e-mails and attach documents within the secure portals about ongoing audit cases; and

- **My Business Enquiries** service within My Business Account is another electronic communications tool where clients can submit their account specific enquiries and receive a response in writing from within the secure portal.

As part of our ongoing efforts to improve our digital services and to meet our clients' needs, the CRA is exploring and analyzing the use of other forms of digital correspondence and continues to monitor industry and government wide direction as well as changing technology in this regard.

Technology in Compliance Programs

The CRA is using technology to improve the consistency of our internal audit practices and sharing of information. This will result in taxpayers seeing more consistency in responses from the CRA. Also, the CRA uses electronic tools to risk assess 100 percent of all large business corporate tax returns on a yearly basis, improving our ability to identify high risk transactions

The CRA uses these tools to analyze taxpayer information to assess the tax non-compliance risks of large businesses. Automation allows the CRA to better focus its compliance resources on high risk cases and specific legal entities of interest, thereby permitting more focused and efficient audits.

The CRA has an ongoing IT project that will enable the electronic submission and storage of numerous election forms, including the T2057, T2058, and T2059, and other commonly used forms. The project will improve and enhance services available to taxpayers, including through MyBA (My Business Account), such as viewing filed elections. Taxpayers will have forms and elections processed more quickly and the CRA will realize efficiency gains through reduced manual labour associated to the processing, validation, and physical storage.

Over the next few years, we will continue to invest in business intelligence and expand the Agency's risk assessment capabilities and better focus its resources on the highest risk cases of non-compliance at the national level.

The CRA is also increasingly using technology to analyze the large amount of data contained in tax filings and third-party information sources to identify potential non-compliance. These sophisticated methods are helping the CRA to identify particular aspects of non-compliance by various groups such as wealthy high net worth individuals, those with significant offshore transactions, multi-national enterprises, etc., thereby permitting more focused and efficient audits.

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

Question 1. *Update on Investment to Combat Tax Avoidance and Tax Evasion*

In the 2016 federal budget, it was announced that $444.4 million would be invested over five years to enhance the CRA's 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 targeting criminal tax evaders. Then, in the 2017 federal budget, it was announced that an additional $523.9 million would be spent over five years to prevent tax evasion and improve tax compliance. Most recently, in the 2018 federal budget, the government announced that to further combat tax evasion and tax avoidance, it would invest $90.6 million over five years to address additional cases that have been identified through enhanced risk-assessment systems.

The *2016-2017 Departmental Results Report*, which was published on the CRA website, provided specific information on international and large business, offshore non-compliance, and the *Panama Papers*. TEI would appreciate an update from the CRA on these three matters, including lessons learned and an elaboration of your current areas of focus.

CRA RESPONSE

As noted in the question, to help combat tax evasion and aggressive tax avoidance, the Government made a combined investment of over $1 billion in the 2016, 2017, and 2018 federal budgets. This investment has allowed the CRA to continue to expand the tools it has to improve compliance.

Electronic Funds Transfers

With our new systems, we are increasingly able to automatically access and review all international electronic funds transfers (EFTs) over $10,000 entering or leaving the country. This represents over 1 million transactions each month. Reviewing these transfers helps us identify transactions on which taxes should potentially have been paid, and better risk-assess individuals and businesses.

Since January 1, 2015, financial institutions have been required to report to the CRA all international EFTs of $10,000 or more. As of March 31, 2018, the CRA had analysed over

187,000 EFTs, involving over $177 billion, related to eight jurisdictions or financial institutions of concern.

Panama Papers

The Agency's review of the Panama Papers has already identified over 3,330 offshore entities with 2,670 possible beneficial owners that have some link to Canada. The Agency has reviewed and risk-assessed over 80 percent of these possible beneficial owners. The Agency is currently auditing over 1,100 taxpayers with offshore links, and 10 percent of these relate to the Panama Papers.

As of March 31, 2018, the Agency had 50 cases of offshore tax evasion under investigation. These include several related to the Panama Papers, whereby multiple search warrants have been executed.

Building on the foundation established in addressing the Panama Papers, the Agency has begun to review the more recent Paradise Papers. For both sets of Papers, the CRA will share information with treaty partners and take appropriate actions to ensure compliance with tax laws. These actions include conducting criminal investigations into tax evasion, tax fraud, and other serious violations of tax laws, and, where warranted, referring files to the Public Prosecution Service of Canada (PPSC) for criminal prosecution. Upon conviction, tax evaders face court imposed fines, jail time, and publicity of their conviction, in addition to having to pay the taxes they tried to evade, plus interest and penalties.

Key results from 2017–2018: International, large business and offshore compliance activities

- We completed almost 5,600 international and large business audits, which includes over 2,700 aggressive tax planning audits and 235 offshore audits.

- Our international and large business audit activities identified almost $8 billion in fiscal impact,[1] including $2.9 billion from our efforts to combat aggressive tax planning. Fiscal impact consists of tax assessed, tax refunds reduced, interest and penalties, and present value of future federal tax assessable arising from compliance actions. It does not account for the impact of appeals reversals and uncollected amounts. $719 million of fiscal impact was refunded during 2017–2018 through the resolution of double taxation issues with Canada's treaty partner countries. This amount has been included in our program results for prior years.

[1] Fiscal impact consists of tax earned by audit (TEBA), provincial taxes, and federal interest and penalties not included in TEBA. It excludes the impact of appeals reversals and uncollectable amounts.

- As part of our budget investments, we have significantly exceeded our target results of $319.5 million and identified $500 million in additional Tax Earned by Audit (TEBA).[2]

- We assessed approximately $21 million in income tax third party penalties.

- We received 196 calls and 93 written submissions through our Offshore Tax Informant Program.

We received approximately 14.9 million reports of electronic funds transfers over $10,000.

Question 2. *Auditor General's Report: Report 2, Income Tax Objections*

In the fall of 2016, the Office of the Auditor General of Canada released its report on the CRA's management of income tax objections. That report set out a number of recommendations focused on improving the time the CRA takes to provide taxpayers with decisions on their objections and the sharing of those decisions within the CRA. In response to the report, the Minister of National Revenue (the "Minister") stated that an action plan was underway to reduce processing times and the plan would be ready at the beginning of 2017.

In December 2017, TEI asked the CRA to share details of the action plan and the impact it was expected to have on the objection process for large corporations with more complex objections. In its response, the CRA indicated that, starting in January 2018, it would be reviewing processes used by the Agency to address large-file objections and engaging with multiple Canadian Tax Professional Associations to solicit input from tax practitioners. TEI would appreciate an update from the CRA regarding the status and any results of this review.

CRA RESPONSE

Following the release of the Auditor General's Fall 2016 Report on Income Tax Objections, the CRA implemented action plans to address the recommendations made by the Auditor General and Parliament's Standing Committee on Public Accounts; these action plans have resulted in:

- The implementation of a service standard aiming to resolve low-complexity tax objections within 180 calendar days, 80 percent of the time, on April 1, 2017. This service standard was met over 90 percent of the time at the end of Q2, 2018–2019.

- The implementation of a service standard aiming to resolve medium-complexity tax objections within 365 calendar days, 80 percent of the time, on April 1, 2018, with the

[2] TEBA comprises federal income tax adjustments for the years audited plus future years' adjustments discounted to the net present value and the value of GST/HST recoveries plus third-party, transfer pricing and gross negligence penalties. It does not account for the impact of appeals reversals and uncollected amounts.

expectation of attaining this target in 2020–2021. This target is currently being met 73 percent of the time, which exceeds forecasted results.

- The inventory of regular objections has been reduced by 25 percent since Q2, 2016–2017 (from 55,076 to 41,428 at the end of Q2, 2018–2019).

Improvements have been made to the CRA's website in order to better inform taxpayer expectations, such as adding average timelines for assignment and resolution of low- and medium-complexity objections, as well as a comprehensive decision tree to identify the best channels to address income tax issues. A decision tree for GST issues will be implemented by early 2019.

- The CRA has collaborated with the Chartered Professional Accountants of Canada on two blog posts on the objection process and how to accelerate dispute resolution.

- The OAG's report showed that 84 percent of decisions fully or partly in favour of taxpayers were due to new facts presented at the objection stage. To improve these results, the Agency implemented the Feedback Loop process to foster and strengthen collaboration between its program branches in order to learn from objection decisions. The Feedback Loop process is breaking down silos within the Agency and facilitating a more client-centric approach within all programs; it provides meaningful information to assessing, verification, and audit programs through regular communication between the Appeals Branch and these programs, the distribution of national-, regional-, office-, and case-level objection decision reports, as well as research and analysis of objection decisions. These processes have been initiated to improve program policies and procedures, as well as train staff.

- A review of all key processes related to the processing of objections was conducted, resulting in the identification of a number of opportunities for efficiencies. Examples of initiatives already implemented include the automation of some data collection and data-entry steps, updated forms and procedures, the elimination of unnecessary data captures, and the introduction of a triage function for low-complexity and some medium-complexity objections. In many cases, this triage function has resulted in taxpayers being contacted within 30 days to request supporting documentation, over 100 days earlier in the process.

- The Agency has added resources to address the workload of high-complexity objections, including an additional large-file team in Calgary, and it conducted a process review specific to large-file objections in January 2018. As a result of this process review, the Appeals Branch is developing a framework that will encourage a consistent approach in meeting with taxpayers with large-case files and/or their representatives in order to provide enhanced service through improved communication. In this regard, a new framework will be in place in early 2019.

The Objections Program has improved its data integrity and performance reporting; timeliness reporting includes all the time an objection's resolution falls within the control of the Government of Canada and excludes time spent awaiting supporting information from the objector.

Question 3. *New Revenue Recognition Reporting Rules*

With IASB International Financial Reporting Standard ("IFRS") 15, *Revenue from Contracts with Customers*, now in force, taxpayers are filing returns supported by financial statements that use IFRS 15. In addition, IFRS 16, which recharacterizes many leases as capital asset additions, takes effect on January 1, 2019. And IFRS 17, which introduces significant changes to the reporting of insurance contracts, takes effect in 2021. In general, these standards require enterprises to report more on the economic substance of a transaction, rather than on the true legal rights and obligations created (i.e., legal substance). They also represent an increase in differences with other forms of Generally Accepted Accounting Principles that are used by taxpayers as a starting point in the determination of net income for tax purposes. TEI would appreciate an update on the CRA's efforts to educate taxpayers regarding the impact, if any, of these new accounting standards on long-established principles governing the determination of net income for tax purposes.

CRA RESPONSE

The CRA's views on the potential impact of new accounting standards is published in several documents. These include:

- Income Tax Technical News 44; and
- Income Tax Technical News 42.

The CRA has also provided online guidance to taxpayers on its webpages titled:

- International Financial Reporting Standards (IFRS); and
- Impact of the IFRS on taxable income.

As noted by the CRA in previous forums with regards to the change in accounting standards from previous Canadian GAAP to IFRS, the Income Tax Act does not specify that financial statements must be prepared following any particular type of accounting principles or standards to determine profit. As the Supreme Court of Canada (SCC) stated in *Canderel Limited v. The Queen*, 98 DTC 6100, the determination of profit is a question of law. Accounting standards are not law. In seeking to ascertain profit, the goal is to obtain an accurate picture of the taxpayer's profit, for purposes of section 3 of the Act for the given year. The SCC stated that a taxpayer is free to adopt any method which is not inconsistent

with: (a) the provisions of the Act; (b) established case law principles; and (c) well-accepted business principles.

In general, subsection 9(1) provides that a taxpayer's income from a business is the taxpayer's profit for the year, with profit generally being determined based on well-accepted business principles. Subsection 9(1) may be adjusted by other provisions in the Act which allow or require adjustments to reported profit in arriving at income for tax purposes. Canadian tax legislation and jurisprudence provide rules and guidance for virtually all transactions. For instance, courts have determined that leases are to be accounted for based on the legal rights of the parties.

The CRA considers that financial statements based on IFRS would be the normal starting point to determine income for tax purposes where IFRS is a taxpayer's accounting method for financial statement purposes. As well, where a taxpayer is using IFRS, we would expect them to apply IFRS on a consistent basis to all calculations in order to determine income tax, except as noted above where the Act requires otherwise. We acknowledge that the adoption of new accounting standards may result in the computation of taxable income becoming more complex and that there may be timing issues in the recognition of income as a result of changes to IFRS standards.

Question 4. *Certificates of Residency*

In November 2015, TEI posed a number of questions regarding the issuance of certificates of residency by the CRA, a common theme of which concerned the CRA's need to reduce processing times for taxpayers. While processing times appear to have improved for some, many taxpayers continue to suffer unreasonably long delays in obtaining certificates of residency from the CRA. With the CRA's increasing use of technology, what measures of automation could be introduced to expedite the certificate-of-residency issuance process? What other efforts is the CRA undertaking to better streamline its residency certification program?

In its response to one of TEI's 2015 questions, the CRA indicated that, where appropriate, it would "continue to advocate for a reduced need for certificates of residency in order to obtain treaty benefits." TEI would appreciate an update from the CRA regarding the status and any results of this important advocacy effort.

CRA RESPONSE

Internationally, since 2015, there appears to have been further growth in the number and type of specific attestations and foreign government forms required in order to obtain tax treaty benefits. Increased concerns over abusive tax arrangements, as well as tax fraud, has only added to the difficulties already posed by varying legal and official language requirements across the globe to standardization efforts. However, Canada has continued to advocate for further work on reducing administrative difficulties in obtaining treaty benefits at international fora such as the Organisation for Economic Co-operation and

Development (OECD) as well as with our treaty partners. In response, there has been a renewed interest in the Treaty Relief and Compliance Enhancement (TRACE) project to remove administrative barriers for portfolio investors and those using pooled investment vehicles. As announced in the July 2018 IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors, the OECD is assisting interested countries with the implementation of TRACE. The CRA is monitoring these efforts for opportunities to effectively reduce administrative burdens on Canadian taxpayers.

Domestically, the CRA continues to look into ways to better leverage technology in servicing taxpayers. As a result of the existing international barriers, automation is not a viable technological solution for the foreseeable future. We continue to work on streamlining internal procedures. For example, the increase of specific attestations and forms requested by foreign governments has caused the need to routinely refresh internal processing manuals. In the coming months these new procedures will be updated. We will also be adding clearer instructions on Canada.ca for requesting certificates of residency. CRA would be open to discussing opportunities for continuous improvements with TEI.

Finally, Canadian taxpayers may seek assistance from the Competent Authority Services Division of the CRA if they have been denied treaty benefits because of undue delays in obtaining their Canadian certificate of residency.

C. Administrative Matters

Question 1. *SR&ED Form T661 Preparation*

Part 2 of Form T661, *Scientific Research and Experimental Development (SR&ED) Expenditures Claim*, contains a so-called "technical narrative" section in which the taxpayer must report, on a project-by-project basis, information that establishes the nature of its scientific research and experimental development ("SR&ED") work. This information is intended to enable the CRA to carry out an initial review of the work that the taxpayer is claiming and thereby establish, with reasonable confidence, whether the claimed work meets the SR&ED eligibility requirements.

Taxpayers filing Form T661 are subject to a 1,400-word limit in completing their technical narratives, a limitation the CRA imposed in 2008 after consulting with SR&ED claimants and other stakeholders. The intent of this word limit was to encourage claimants to focus on the technical aspects of their projects, as opposed to the business aspects. At the time, it was anticipated that clear and concise descriptions would allow the CRA to expedite its review and process claims as quickly as possible.

Unfortunately, the experience of many TEI members during SR&ED technical reviews suggests that the 1,400 word limit on technical narratives is not having the intended effect. Feedback provided by SR&ED reviewers and research and technology advisors to claimants during these reviews is frequently interrogative in nature (e.g., "Why did you not explain this on the Form

T661?"), to which claimants generally respond that they lacked the necessary space to adequately explain the nature of their SR&ED work.

It is not uncommon for SR&ED projects to be large and sophisticated undertakings, which can be difficult—if not impossible—for claimants to explain in only 1,400 words. For large business taxpayers, the 1,400 word limit on technical narratives can result in an inefficient process that is of little or no benefit to either party. As a process improvement, therefore, TEI recommends that the CRA increase the word limit on Form T661 technical narratives from 1,400 to 2,800 words. Doubling the current word limit should allow taxpayers to provide sufficient information to establish the nature of their SR&ED work in completing Form T661, which would enable the CRA to expedite the SR&ED review process as originally intended.

CRA RESPONSE

We value taxpayer and stakeholder feedback and this suggestion is something we will consider for our next review and update of the SR&ED Tax Credits Claim form (Form T661).

We recognize that for larger businesses, with complex and sophisticated R&D projects, it can be challenging to summarize the outcomes of their R&D work and relate this work to the requirements of the tax credits in approximately 1,400 words.

The CRA stands among other public- and private-sector organizations that are committed to the pursuit of excellence in client experience, and we are committed to ensuring the SR&ED Tax Credits application process is reflective of this commitment.

While we understand the needs of large business are perhaps different in this instance, we have observed improvements in regards to the quality and relevance of information provided by firms since the introduction of the new format. This has been most apparent in businesses with fewer and perhaps less complex R&D projects—a segment which represents the largest portion of applicants in the program.

The profile of businesses claiming the credit does vary, the program supports small and large enterprise, representing all segments of our economy, and we recognize they may experience the program differently, that is why we are working to better understand these differences so that, where possible, we can adapt our processes to make the program simpler to understand and easier to use.

Question 2. *Online Filing of Objections*

The CRA's My Business Account is generally a very useful e-services tool for administering a taxpayer's tax accounts. Where a large corporate taxpayer seeks to file an objection to a notice of (re)assessment or notice of (re)determination using the "Register my formal dispute" option in My Business Account or the Represent a Client service, however, the current objection process requires two steps to accommodate the system's 2,500-character limit:

- ✓ [Step 1] the taxpayer must type "Please see attached objection, X issues and Y pages," and click submit using "Register my formal dispute"; and

- ✓ [Step 2] the taxpayer must then immediately submit the objection attachment with the facts, reasons relied upon, and relief sought via the "Submit Documents" option.

As a process improvement to ensure that the taxpayer's notice of objection and supporting documentation are filed together as one complete submission, with the facts, reasons relied upon, and relief sought in the "Register my formal dispute," TEI recommends that the CRA:

(i) add functionality to attach the completed objection information as part of the "Register my formal dispute" process; and

(ii) add the same functionality to "Register my formal dispute" (notice of objection) for GST/HST (RT accounts). Currently, a taxpayer is unable to submit separate completed objection information via the "Submit Documents" option.

CRA RESPONSE

The CRA confirms that objections filed online are legally valid; please see the blog posting prepared in collaboration with the CPA to that effect at https://www.cpacanada.ca/en/business-and-accounting-resources/taxation/blog/2017/december/common-reasons-for-invalid-tax-objections. The functionality to allow online filing of GST/HST objections through "Register my formal dispute" under the CRA's My Account portal is expected to be available in October 2019.

Although the "Submit documents" option currently exists to allow taxpayers to attach all relevant documentation to their objection, the Appeals Branch will take this suggestion under advisement, and plans to work with its partners to improve the overall functionality of its eServices.

Question 3. *Holding Appeals in Abeyance*

Where a taxpayer has served notice of objection to an assessment (or reassessment) under section 165 of the Income Tax Act,[3] the taxpayer may appeal to the Tax Court of Canada to have the assessment vacated or varied. In many instances, however, the appeal of an assessment in respect of the taxpayer for a taxation year can impact multiple taxation years of the taxpayer, but only one of those years is appealed while the other(s) are held in abeyance with CRA Appeals pending final adjudication of the appeal. Similarly, in the case of a partnership or joint

[3] Unless otherwise indicated, all references to "section," "subsection," or "paragraph" herein are to sections, subsections, or paragraphs of the federal Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), as amended (the "Act").

venture, one partner or joint venturer might appeal an assessment to the Tax Court, while the other partner(s) or joint venturer(s) hold their appeals—with identical facts—in abeyance.

TEI is aware of at least one instance where a CRA Appeals officer has indicated that he will no longer be holding files in abeyance pending the outcome of litigation, and has proposed to confirm other related assessment(s). Thus, the only recourse for the affected taxpayer(s) would be to appeal to the Tax Court to have the other assessment(s) vacated or varied, which involve the same issues already on appeal before the court. In TEI's view, this represents an unnecessary and duplicative use of judicial resources, as well as an undue burden on the affected taxpayer(s). Would the CRA be amendable to sharing its administrative policy or practices regarding the determination of whether to hold an objection or appeal in abeyance, including any relevant factors that are taken into consideration?

CRA RESPONSE

The Appeals Branch considers a file "Non-workable" during the periods of time an Appeals officer is unable to work on the objection due to circumstances outside of the officer's control. Section 4.6.1.3 of the Appeals Manual describes the situations were cases are considered Non-workable due to similar or related issues:

> **4.6.1.3. Objectors or groups of objectors with similar or related issues:** where the principal file is awaiting HQ review for potential test case selection, under appeal, or awaiting expiry of the next appeal period. The principle file has a non-workable code 3H. Those awaiting the decision on the principal file are to be coded 1B.

It continues to be Appeals Branch practice to hold cases in abeyance when related cases or principal files are under appeal. If the issue in the objection is identical or dependant on the result of the court decision of the principal file, the appeals division will hold the secondary files in abeyance awaiting the court decision on the principal or related files. The same situation will apply for taxpayers who have earlier years under appeal and subsequent years under objection if the issues are identical.

Without more context regarding the situation described in the question, it is difficult to ascertain the reasons why the files under objection were removed from non-workable status. There may have been a valid reason. However, if there are concerns regarding the removal of cases held in abeyance, this should be discussed with the Appeals officer and their team leader.

D. Audit/Appeal Matters

Question 1. *Audit Approach*

In 2011, the CRA began a five-year process of phasing in its new risk-based Approach to Large Business Compliance ("ALBC"). TEI would appreciate an update from the CRA regarding the ALBC's evolution in recent years and how it might continue to evolve in the future. TEI is particularly interested in what large business taxpayers might experience during their ongoing audits, which may cover periods as far back as 2014, and how that experience might change as their audits become more current. We invite the CRA to discuss (i) the role of the large file case manager and the composition of the audit team, (ii) how risk is assessed for purposes of the ALBC, (iii) the impact of the risk assessment on the audit, and (iv) the use of data-driven analytics by the CRA under the ALBC.

CRA RESPONSE

The International and Large Business Directorate (ILBD) is in the process of refreshing its ALBC strategy.

The Integrated Large Business Audit Teams (Integrated Teams), led by the International and Large Business Case Manager (Case Manager), reinforce the CRA's team approach to compliance. The Domestic, International, and Abusive Tax Avoidance (ATA) auditors within the teams all contribute to the risk assessment and audit process based upon their respective subject matter expertise. The Case Manager is responsible for the overall audit case and acts as a single point of contact between the CRA and the taxpayer thus supporting the concept of "One Team - One Voice - One Audit." The assignment of workload and the composition of the Integrated Teams is based on risk, complexity, and capacity.

The CRA uses an integrated risk-based approach to large business compliance to identify and address the highest risk cases nationally. On an annual basis the large business population is subject to a comprehensive integrated risk assessment process using CRA's Integrated Risk Assessment System (IRAS). This automated system applies risk algorithms that run on the CRA's databases to identify risk issues and generate a risk ranking of the large business population. This is known as Tier I risk assessment.

The Tier I risk issues are then pre-populated in a screening case within the CRA's audit case management system (Integras) for those taxpayers that are considered to be high risk. These screening cases identified by IRAS are selected for regional and national calibration exercises, a subsequent review process at the regional and national level to ensure consistency in selecting the cases. These calibration exercises are referred to as the Tier II stage. Once the calibration exercise is complete, these cases can pass through directly to the Tier III - Risk Assessment and Validation (RAV) stage.

Those taxpayers that are considered high risk per the work plan will be selected for a full compliance audit starting at the Tier III – Risk Assessment and Validation stage. The Integrated Team will contact the taxpayer, and conduct the audit planning and governance document review process. The Integrated Team will take into consideration whether the taxpayer has an effective Tax Control Framework (TCF) in place. Taxpayers that are open and transparent about their tax risks/uncertain tax positions will enable the Integrated Team to more quickly determine whether the taxpayer remains high risk or is in fact low risk. To the extent the taxpayer is low risk the Tier III case will be closed thereby providing the taxpayer with earlier tax certainty, and the CRA with a level of assurance that the taxpayer is compliant and has reported and paid correct amount of tax.

For those taxpayers that remain high risk and that may be less than transparent about their tax risks/uncertain tax positions, the CRA will proceed with the full compliance audit. This more targeted approach will continue to include many of the largest businesses in Canada. In some cases, depending on the number of high-risk legal entities within the economic group, and/or lack of cooperation by the taxpayer, a second Integrated Team may be assigned to examine the other high risk legal entities within the group to ensure compliance. This may increase the level of compliance burden and tax uncertainty for the taxpayer. The CRA will communicate to the taxpayer the significant tax audit issues in the case and the reasons for assigning more resources if applicable. This may take place during an ALBC face-to-face meeting.

The CRA will continue to conduct face-to-face ALBC meetings towards the conclusion of the audit of the highest risk and least cooperative taxpayers to communicate to the entity's senior management the unresolved compliance issues, any lack of openness and transparency experienced by the audit team and any issues related to disputes over access to information or other issues encountered by the taxpayer or the audit team during the audit. These face-to-face meetings will be used to achieve more compliant behaviour from the highest risk and least cooperative taxpayers within the population. The CRA will continue to promote voluntary compliance by increasing transparency and strengthening mutual trust and cooperation with Canada's largest business entities. The CRA's overall objective is to promote voluntary and cooperative compliance.

The CRA also invites face-to-face meetings, at the beginning of an audit or at any time, at the request of taxpayers to discuss specific issues or concerns, or to help explain business operations and tax compliance approaches to the audit team.

The CRA is in the process of refreshing its ALBC strategy based on our integrated team approach to compliance and our enhancement risk assessment systems, and will consult with external stakeholders on an informal basis over the coming months. The cornerstone of our ALBC strategy will be to allocate resources and capacity based on risk and complexity to increase voluntary compliance and to optimize our results.

Question 2. *Bringing Audits Current*

This question concerns large business taxpayers whose income tax affairs are continually under audit by the CRA. From the perspective of such taxpayers, the ideal audit process might be one where tax returns are picked up for audit shortly after being filed, the audit is completed within a year or two of its commencement, and any objection filed by the taxpayer in relation to any assessment would be objectively reviewed by CRA Appeals within one year. Timelines like these would allow queries to be answered while memories remain fresh and records are readily available, and would produce administrative efficiencies for both taxpayers and the CRA. Unfortunately, the current system is far from this ideal.

How does the foregoing compare to the CRA's perspective on ideal timelines for the completion of large case file audits and appeals? What are the current statistics for the timeliness and currency of large case file audits? What are the current statistics for the resolution of a large case file appeal? Does the CRA have a service standard in relation to large case file audits (e.g., time from filing of return to completion of audit) and appeals (e.g., time from filing of objection to completion of review)?

A number of TEI members have reported that their income tax audits often persist until shortly before the expiration of the statutory limitation period. We invite the CRA to comment on precisely how it plans to become more current in its audits, including what becoming "current" in this context means from a CRA perspective. Will the CRA continue to focus its audits on two taxation years at a time? Does the CRA expect that the July 2018 draft legislative proposal to extend the special reassessment period for cross-border non-arm's-length transactions to all transactions with foreign affiliates will impact the timeliness of foreign-affiliate audits?

CRA RESPONSE

International, Large Business and Investigations Branch (ILBIB)

Large businesses seek earlier tax certainty with respect to their uncertain tax positions. As indicated, the objective of the large business audit function is to examine and validate the level of compliance. That is, to obtain a certain level of assurance that the taxpayer has reported and paid the correct amount of tax. To the extent that the taxpayer provides the required information to validate that the risk of non-compliance is in fact low, the CRA can close its audit case more quickly.

The CRA's objective is to ensure that large business taxpayers report and pay the correct amount of tax under the law. Taxpayers are entitled to plan their tax affairs to pay the least amount of tax allowable under the tax rules. Those taxpayers that take a more aggressive approach to tax planning, or engage in abusive tax avoidance, for example, are considered higher risk from a non-compliance perspective. A substantial portion of reassessments and disputes with taxpayers relate to interpretive issues around the application of transfer pricing rules, GAAR or other anti-avoidance rules.

Our focus is to ensure through effective compliance activities that taxable income is not understated or that tax attributes and pool balances are not overstated. To the extent that the CRA is able to validate, based on sufficient appropriate audit evidence, that the risk of non-compliance is low, the CRA will be in a position to close the particular audit, and provide earlier tax certainty to the taxpayer. The CRA is committed to improving audit currency for large corporate taxpayers (i.e. reducing the lag between filing and commencement of audits, as well as addressing protracted audits). This commitment will require co-operation from large business. Audit timelines to a large extent are dependent on the level of openness and cooperativeness by the taxpayer and its representatives in providing the required sufficient appropriate audit evidence to enable the CRA to validate that the risk of non-compliance is in fact low. There are no formal audit timeline standards but as a general guide, the audit of a large business taxpayer that is considered high risk and less than cooperative can take up to two years or longer to complete, whereas the audit of a taxpayer for which the CRA has validated to be low risk can be completed in a relatively short period of time.

Generally, through openness, transparency, cooperation, and disclosure of uncertain tax positions, the CRA can more efficiently and effectively validate the level of risk thus reducing the compliance burden and achieving earlier tax certainty for compliant and cooperative taxpayers.

The intent of the Budget 2018 measure to extend the special reassessment period for cross-border non-arm's-length transactions to all transactions with foreign affiliates, is not to prolong audits but instead to reduce the incentive to withhold information needed to complete audits. We anticipate that taxpayers will provide more information in a timelier manner as a result of this amendment, which should help improve audit currency.

As long as taxpayers continue to be cooperative with auditors in the provision of all information requested in a timely manner, the CRA does not expect the duration of foreign affiliate audits to change significantly.

Appeals

- Given the varied complexity and technical content of the matters involved in large-case objections, it is difficult to identify an ideal timeline for their resolution.

- The average time for the resolution of a large-file objection is 690 days, as of November 2, 2018.

- While it has published service standards for both low- and medium-complexity objections, the CRA does not have a service standard in relation to the resolution of large-file objections.

- As conveyed in the response *B2 Auditor General's Report: Report 2, Income Tax Objections*, the Agency is taking concrete steps to improving the processes related to large-file objections.

Question 3. *Cooperative Compliance*

In recent years, the CRA has been allocated additional funding to increase its audit resources with an aim to modernize its systems, combat noncompliance, hire and train additional staff, and generate more fiscal revenue. It is perhaps no coincidence, therefore, that large business taxpayers have reported experiencing more aggressive audits in recent years, which can be highly disruptive and require significant resources from both the CRA and taxpayer.

An increasing trend in the administration of large business tax compliance around the world is the use of cooperative compliance programs. These programs generally facilitate the proactive identification and resolution of material tax issues through open, cooperative, and transparent interaction between tax administrators and large business taxpayers—in some cases *prior* to the filing of a return. Taxpayers participating in these programs can achieve a greater degree of certainty sooner and with less administrative burden than under conventional post-filing audit regimes.

Globally, around 60 percent of the Organisation for Economic Co-operation and Development's Forum on Tax Administration members report having in place, or being in the process of implementing, a cooperative compliance program for large business taxpayers. In most jurisdictions, these programs are based on formal agreements between tax administrators and specific taxpayers. Such agreements typically require taxpayers to commit to the effective management of their tax affairs, the presence of a formal tax control framework, and the absence of pending issues or arrears.

The CRA participates in the OECD's Forum on Tax Administration and is aware of these cooperative compliance programs. TEI invites the CRA to share its views regarding cooperative tax compliance and whether it has considered implementing such a program in connection with its efforts to modernize and become current.

CRA RESPONSE

The CRA plays a leadership role in the Large Business and International Program of the Forum for Tax Administration, which currently has several projects underway to prevent international disputes, facilitate common approaches to transfer pricing issues, and help resolve disputes more efficiently. These are:

- The **International Compliance Assurance Program (ICAP)** pilot, launched on January 23 2018, is being led by the Forum on Tax Administration. ICAP is a voluntary program that will use Country-by-Country reports and other information to facilitate open and co-operative multilateral engagements between MNE groups

and tax administrations, providing groups willing to engage actively and in a fully transparent manner with increased tax certainty. By coordinating conversations between a group and tax administrations in several jurisdictions, ICAP should ensure a more effective use of transfer pricing information, a more efficient use of resources both for groups and for tax administrations and, in the longer term, fewer cases entering into mutual agreement proceedings. Canada is participating in the pilot along with Australia, Italy, Japan, the Netherlands, Spain, the United Kingdom, and the United States. The CRA is committed to continued support for this forward-thinking OECD initiative that demonstrates the value of multilateral collaboration and the relationship between tax transparency and certainty. Participating tax administrations are currently working together to embed lessons learned into the governing ICAP handbook which will lay the foundation for a possible broader roll-out of ICAP following the completion of the pilot, scheduled to conclude in mid-2019.

- The **Comparative Risk Assessment Initiative (CRAI)**, which builds on the ICAP experience, where early work highlighted divergences of views and approaches to risk assessment, the CRAI is aimed at examining how individual tax administrations asses risk in areas that lead to most disputes (i.e., transfer pricing and permanent establishment issues). Countries are working together to describe specific transactions and areas of transfer pricing risk that could be cataloged. This broader work on risk assessment is intended to provide a foundation to improve audit capabilities, facilitate more streamlined multilateral work, build consensus around the administration of transfer pricing rules, and increase confidence in the robustness of the assurance process. Twenty-four countries are participating on the CRAI.

- The **Joint Audit project**, being led by the Netherlands, is exploring ways to facilitate more joint and multilateral audits with a view to achieving earlier tax certainty and avoiding MAP disputes. Joint audits represent a form of coordinated action between and among tax administrations. In a joint audit, two or more countries join to form a single audit team to conduct a taxpayer examination. Joint audits result in quicker issue resolution, more streamlined fact finding and more effective compliance. Joint audits also have the potential to shorten examination processes and reduce costs, both for revenue authorities and for taxpayers. Canada is currently in discussions with Germany to pilot a joint audit of a specific taxpayer.

- The **Common Reporting Standard (CRS)** became law in July 2017, making it mandatory for financial institutions to identify bank accounts held by, or for the benefit of, non-residents and to provide account details annually to the CRA. The CRA then shares this information with foreign jurisdictions. In turn, the CRA receives the same type of information from other jurisdictions. The CRA began its CRS exchanges in September 2018.

- The **Advance Pricing Arrangement (APA) program** is a proactive service offered in resolving transfer pricing disputes that may arise in future tax years. Every year the Competent Authority Service Division produces its APA report to be posted on the external website. By increasing the rigour and diligence at the beginning of the APA process the CRA continues to decrease timelines.

Question 4. *Consistency of Audit Positions*

Several TEI members have experienced audits in which a CRA field auditor proposes to take a position on a tax matter that is inconsistent with a position of the Head Office, with the field auditor stating his or her disagreement with the Head Office position. TEI assumes that the CRA aspires to treat similarly-situated taxpayers similarly through consistent application and uniform enforcement of tax laws. Would the CRA comment on whether they agree with this statement and, if so, the steps a taxpayer should take when confronted by a field audit team that proposes to assess in a manner that is inconsistent with a Head Office position?

CRA RESPONSE

Yes, the CRA supports consistent application and uniform enforcement of tax laws.

The International and Large Business Case Manager (ILBCM) acts as a single point of contact if a large business taxpayer is under audit. If you do not agree with your ILBCM, escalate the matter to:

- your ILBCM's direct manager in the TSO; then
- the Assistant Director of Audit of the TSO; then
- the Director of the TSO; and, if necessary,
- the Directors or Director General of the International and Large Business Directorate in HQ.

While this is the appropriate process for escalating concerns, note that this does not necessarily mean that field positions will be reversed at more senior levels or in headquarters. Senior officials will attempt to understand both sides of a given situation and work out practical next steps. In cases where auditors' actions are, in our view, reasonable and founded in appropriate and defensible assessing positions, taxpayers who continue disagree will need to use the objections and appeals process.

Question 5. *Audit Procedures – Transfer Pricing*

a) TEI commends the CRA's efforts to move toward a risk-based approach to managing income tax audits. What progress has the CRA made to date in updating its transfer pricing-related audit guidance and procedures to reflect a risk-based approach?

In particular, the last sentence of paragraph 9 in Transfer Pricing Memorandum TPM-05R, *Requests for Contemporaneous Documentation*, appears to clarify that CRA auditors may request documentation on select intercompany transactions, and that this approach is consistent with a risk-based approach:

> If requests were restricted to transactions involving a specific non-resident, additional requests must be issued for other non-residents if the scope of the audit is expanded later.

Unfortunately, the Sample Contemporaneous Documentation Letter appended to TPM-05R appears to address only full contemporaneous documentation requests. No sample letter appears to have been developed for field auditors who might want to take a risk-based approach and restrict their initial documentation requests to certain transactions. Both the CRA and taxpayers would benefit if auditors were to employ a risk-based approach to scoping their documentation requests. TEI invites the CRA to share its views on the matter.

CRA RESPONSE

While the CRA's risk-based approach to audit and in this case, transfer pricing audits, generally requires first an appropriate identification and analysis of all material transactions undertaken by Canadian taxpayers with non-resident, non-arm's length parties, in some cases it is readily apparent, based on prior audits, commercial understanding and high level information provided by the taxpayer, that some transactions are routine and/or immaterial. Responses to contemporaneous documentation requests enable the CRA to review and focus attention on relevant, high risk transactions and from there, scope their further enquiries to those specific high risk issues with the taxpayer; this is a component of the CRA's risk-based approach to audit. The sample contemporaneous documentation letter, as outlined in TPM-05R, continues to be an effective means of obtaining taxpayer information. In certain limited circumstances, with approval from the International Tax Division, auditors may change the sample contemporaneous documentation letter to focus on specific risk factors which have been identified through initial risk assessment. The CRA continues to reserve the right to examine any transactions/arrangements at any time during the audit process.

b) Country-by-country ("CbC") reporting was specifically introduced to assist tax authorities in transfer pricing risk analysis. TEI invites the CRA to comment on how it sees future audits changing as a result of having this CbC information. Would the CRA be able to share the findings from its review of taxpayers' 2016 CbC reports?

CRA RESPONSE

The first exchanges of tax, revenue and profit information for Canada and other countries' largest multinational enterprises (MNEs) under the CbC reporting initiative took place in June 2018. With this sharing of information, the CRA is fulfilling a commitment announced by the Minister of National Revenue in May 2016 as part of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project to increase transparency through the automatic exchange of this information between tax authorities.

Participating in the exchange of this information demonstrates Canada's commitment to global collaboration to ensure transparency and a tax system that is fair to all. The CbC initiative is an additional tool to ensure compliance and help the CRA make it more difficult for corporations to shift their profits offshore to avoid paying their fair share of tax.

Shared information is secure and will be used for high-level transfer pricing risk assessment and for statistical and economic analysis.

Question 6. *Audit Performance Statistics*

TEI invites the CRA to describe the statistics it keeps to track audit effectiveness, be it "tax earned by audit," "additional tax assessed by audit," "fiscal impact," or other. Could the CRA confirm whether any of these or another similar metric captures downward adjustments for assessments that are ultimately overturned on objection and appeal? Further, with respect to assessments that have timing differences in the future, such as a change in the capital cost allowance classification of depreciable property, does the Minister keep any statistics that might incorporate the future impact of such assessments? If so, how?

CRA RESPONSE

The CRA does not currently capture downward adjustments for assessments that are ultimately overturned on objection and appeal, however, we have begun analysis in this regard. This type of longitudinal analysis, matching audit files from earlier years to their Appeals outcomes in later years is labour-intensive.

With respect to assessments that have timing differences in the future, such as a change in the capital cost allowance classification of depreciable property, the CRA does capture these statistics. The Net Present Value of the adjustment is recognized as Tax Earned by Audit (TEBA).

Historically, tax authorities have relied upon Audit Yield performance measures to determine their impact on compliance. Audit Yield is generally the difference between the amount of tax self-assessed by the taxpayer and the additional tax identified and reassessed

as a result of compliance activities. Audit Yield can be easily measured given the direct correlation between audit effort and audit results, and indicates the level of efficiency of the audit activities. However, Audit Yield doesn't necessarily capture the tax authority's impact on voluntary compliance nor does it reflect the final outcome of tax audits and disputes. The CRA's general Audit Yield performance measures include TEBA and fiscal impact. TEBA includes federal tax equivalent of adjustments to taxable income, the net present value of the federal tax equivalent to adjustments to tax pools, and certain penalties assessed. Fiscal impact includes TEBA plus the provincial/territorial equivalent of current audit adjustments.

The large business audit program is updating its performance measures by developing a Compliance Measurement Framework. As part of this initiative, the International and Large Business Directorate has commenced the introduction of a performance measure, similar to Tax Assured or Justified Trust used by other tax authorities. The CRA refers to this measure as Validated Risk. Validated Risk is an outcome measure that indicates the level of confidence and assurance in the tax system based on the CRA's risk assessment process and taxes being paid voluntarily. Validated Risk can indicate, over time, the effectiveness of the tax authority in achieving the desired compliance outcome. This measure requires a certain amount of monitoring and validation to conclude that the tax authority has a level of "justified trust" in a certain proportion of the tax base. It generally requires a well-defined population segment that is subject to a risk-based approach to compliance, similar to the CRA's ALBC for the large business population segment. As previously indicated, the CRA conducts a risk assessment and validation of the highest risk taxpayers nationally at the early stage of the audit process. A quality risk validation of a large business taxpayer at this stage will qualify for the Validated Risk outcome measure.

Large business taxpayers are seeking earlier tax certainty with respect to their tax filing positions. At the same time, through its compliance activities, the CRA examines and validates the level of compliance in order to obtain a certain level of assurance that the taxpayer has in fact reported and paid the correct amount of tax. Validated Risk allows the audit function to take recognition for a quality risk validation even if it may result in a "no change" case from an Audit Yield perspective. This contributes to more timely case closure, earlier tax certainty, and lower compliance burden for low-risk cooperative taxpayers. The Validated Risk performance metric will be implemented in the coming year.

Question 7. *Referring Issues Under Objection to CRA Audit*

TEI understands that it is the role of the CRA Appeals Division, as outlined in recent versions of the CRA *Appeals Manual*, to review the audit file, discuss the matter with the objecting taxpayer, consider the available information, apply the law, and reach a decision. If the issue in question requires additional audit work, the *Appeals Manual* suggests that the reviewer should refer a matter under objection back to CRA Audit only in "exceptional circumstances." Such a referral would appear reasonable in situations where the CRA Appeals Division reaches a different legal conclusion than the taxpayer or CRA auditor, and that conclusion requires the verification

of additional facts or circumstances not contemplated at the time of the audit. However, taxpayer experience demonstrates that matters under objection can be referred back to CRA Audit in less than exceptional circumstances (e.g., the audit file before the Appeals Division is incomplete or insufficient to substantiate the reassessment).

TEI is concerned that this practice may provide a procedural mechanism to effectively circumvent the normal reassessment period. In situations where the normal reassessment period is about to expire, an auditor could make a generic reassessment without any request for sufficient information to verify or refute the conclusion. With insufficient information to determine the issue in question, the CRA Appeals Division could refer the matter back to CRA Audit, effectively allowing the latter to continue their audit work after the expiration of the normal reassessment period and without further time limitations. TEI invites the CRA to comment on these concerns and share its views regarding what would (or would not) constitute "exceptional circumstances" in this context.

CRA RESPONSE

The Agency makes every effort to fully audit and reassess files within the reassessment period. A "protective reassessment" is used only as a last resort and, typically, where there have been challenges—often extreme challenges—in obtaining information from taxpayers during the audit period.

Issues under objection may be referred to audit under the Protocol between the Appeals Branch and the Compliance Programs Branch of the Canada Revenue Agency. The purpose of this protocol is to help ensure that tax issues are resolved at the audit stage in full consideration of relevant information.

The intent of this protocol is not to create a back-door means of extending the reassessment period. The protocol both encourages taxpayers to provide information at the audit stage so that a proper and complete determination of taxes owing can be made at that time, and allows a more efficient mechanism for properly determining taxes owing in cases where new information is provided at the objection stage, rather than during the audit. CRA auditors strive to maintain an open dialogue with taxpayers throughout the process to ensure timely resolution and minimise costly and time-consuming appeals. When information is not made available, it undermines the value of audit proposals and reassessments.

This protocol outlines the roles and responsibilities of appeals officers and auditors in the resolution of objections to (re)assessments resulting from audit activities and sets out the referral process in the following Compliance Program areas:

- Small and Medium Enterprises Directorate (SMED);
- International and Large Business Directorate (ILBD);
- GST/HST Directorate (GST/HST);

- Offshore Compliance Division; and
- Scientific Research and Experimental Development Directorate (SRED).

In addition, it further clarifies timelines, service standards, and communication between the Divisions.

Taxpayers seeking early tax certainty can reduce the risks of a prolonged audit or a protective reassessment by responding promptly and comprehensively to requests for information during the audit.

Context

Taxpayers are entitled to fair treatment in all their dealings with the CRA, including the right to dispute an assessment resulting from an audit. For every valid Notice of Objection received, the CRA is bound to reconsider the assessment and render a decision by conducting a *fair and impartial review* of any disputed (re)assessment. This involves the review of the relevant issues, providing the taxpayers with an opportunity to explain their interpretation of the law and facts, researching the issue and applicable law and, finally, providing a decision based on the impartial review of the law and facts.

An appeals officer handling an objection has complete decisional authority relative to the recommendation to confirm, vary or vacate the assessment, or make a reassessment. Appeals officers will keep taxpayers/registrants informed of any discussions with auditors in the course of resolving the objection to ensure that the process is fair, open, and transparent.

Referrals from the Appeals Division to the Audit Division

During the course of resolving an objection, an objector/authorized representative may provide additional documents not provided/produced at the audit stage. If this new/additional information is substantial, the appeals officer may consider referring the information back to the Audit Division in order for them to perform audit work and provide a recommendation to the Appeals officer.

Please note that the reference to "exceptional circumstances" has been removed by the Appeals Branch from its operations manual. Outlined below are the circumstances where a referral back to the Audit Division will be discretionary or mandatory.

Mandatory referrals – Other than for the GST/HST Refund Integrity Program, where specific documents or information that had been previously requested by the Audit Division are only being provided at the objection stage, the referral is mandatory.

Discretionary referrals – Situations where a referral may be necessary include, but are not limited to, cases where:

- the net tax was estimated due to insufficient books and records;
- input tax credits were disallowed as the accounting records/documentation were not provided;
- the new information available for review is substantial;
- an on-site visit is warranted; or
- the objection relates to an initial assessment concerning issues of prior years' returns currently being considered by the Audit Division.

E. Technical Matters

Question 1. *Capital Cost Allowance – Elections to Include Properties in Class 1*

Under Part XI of the Income Tax Regulations, a taxpayer's depreciable property is grouped into various classes described in Schedule II. The rules in Regulation 1103 allow a taxpayer, under certain conditions, to elect to transfer assets from one class to another.[4] Under Regulation 1103(1), a taxpayer may elect to include in Class 1 of Schedule II all properties otherwise included in any of Classes 2 to 10, 11 and 12 to the extent they are acquired for the purpose of gaining or producing income from the same business. Regulation 1103(4), in turn, provides that such an election will be effective from the first day of the taxation year in respect of which the election is made and will continue to be effective for all subsequent taxation years. In a technical interpretation letter dated January 8, 1980, confirming its position in Interpretation Bulletin IT-327 (July 5, 1976), the CRA stated that:

> [W]here a taxpayer elects under Regulation 1103(1), the election affects all such properties on hand at the commencement of the taxation year and acquired during the year for which the election is made. The election does not affect properties acquired after the end of that year as referred to in your letter but, of course, they could be subject to a later election.[5]

Could the CRA confirm whether this statement continues to reflect its interpretation of the Regulation?

CRA RESPONSE

The CRA confirms that this statement continues to be our position.

Interpretation Bulletin IT-327, *Capital Cost Allowance – Elections under Regulation 1103*, has been cancelled and information regarding the election under subsection 1103(1) has been incorporated into paragraph 1.132 of Income Tax Folio S3-F4-C1, *General Discussion of Capital Cost Allowance*. Paragraph 1.132 states:

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[4] All references to "Regulation" herein are to sections of the current federal Income Tax Regulations, C.R.C., c. 945.

[5] Technical Interpretation 800108 (Jan. 8, 1980).

Section 1103 of the Regulations contains elections that, under certain conditions, permit a taxpayer to transfer property otherwise included in one class to another class. Normally such a transfer is made to defer either immediate recapture or a terminal loss. For example, under subsection 1103(1) of the Regulations, a taxpayer may elect to transfer all properties otherwise included in Classes 2 through 12 (excluding Class 10.1) to Class 1 provided that all such properties were acquired for the purpose of gaining or producing income from the same business. The election affects all properties on hand at the commencement of the tax year for which the election is made, as well as any such property acquired during that year.

Question 2. *Benefits and Allowances Received from Employment*

Since October 2017, Income Tax Folio S2-F3-C2, *Benefits and Allowances Received from Employment*, has been "under review" and the CRA has indicated that employers should continue to follow current practices consistent with the information available in Guide T4130 *Employers' Guide - Taxable Benefits and Allowances*. TEI invites the CRA to provide an update regarding this matter.

CRA RESPONSE

At the Minister's request, Income Tax Folio S2-F3-C2, *Benefits and Allowances Received from Employment*, was removed in October 2017 from the tax pages of the Canada.ca website. The Minister also asked the CRA to review the wording in the folio with respect to employee discounts on merchandise.

The CRA reviewed the wording with respect to employee discounts on merchandise in the folio and drafted new wording.

The revised folio continues to undergo additional review as per our internal procedures. During the review period, the CRA continues to administer employee discounts on merchandise in accordance with the administrative policy outlined in Guide T4130, *Employers Guide – Taxable Benefits and Allowances*, which is currently available on the tax pages of the Canada.ca website.

Question 3. *Cash Pooling Arrangements*

Cash pooling is a common arrangement entered into by multinational enterprises to retain internal control over financing. Intercompany cash pooling arrangements enable multinationals to more efficiently manage liquidity and currency risk among their affiliates on a worldwide basis, reduce borrowing costs, and increase return on excess cash. Under such arrangements, it is not unusual for an affiliate to be both a lender and a borrower in the same taxation year.

Canada has an extremely restrictive regime that governs all cross-border financing arrangements. While the tax rules governing cross-border financing arrangements were enacted to protect the Canadian tax base, they also severely restrict the Canadian operations of multinational companies from the efficient and timely deployment of working capital. These rules can also require complicated analysis on the part of taxpayers and CRA audit teams, even where the amounts arising from cash pooling arrangements are insignificant. Would the CRA be amenable to working with stakeholders to develop a workable solution?[6]

CRA RESPONSE

The CRA reviews the taxation of cash pooling arrangements, as with any cross-border non-arm's length transactions, in accordance with the Act and within the current position on cash pools agreed upon by the international community through the OECD Transfer Pricing Guidelines. We are unable to comment on the assertions made that the Act severely restricts the Canadian operations of multinational companies and do not believe that there is an unreasonable level of analysis required to support these types of arrangements. However, TEI is welcome to provide additional details and context on its question for further consideration by CRA.

[6] TEI will pose the same question to the Department of Finance.