TAX EXECUTIVES INSTITUTE, INC.

INCOME TAX QUESTIONS

Submitted to

DEPARTMENT OF FINANCE CANADA

DECEMBER 5, 2018

Tax Executives Institute Inc. ("TEI") welcomes the opportunity to present the following questions and comments on income tax issues for discussion with representatives of the Department of Finance Canada (the "Department") during our annual liaison meeting on December 5, 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. Legislative Update and Tax Policy Discussion

1. *Legislative Priorities*

TEI invites the Department to provide an update regarding its near-term legislative priorities.

2. *Tax Policy Discussion*

The following questions are intended to raise broader questions of tax policy on a discussion basis. All discussions are conducted under the Chatham House Rule, whereby participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.

a) *Tax Competitiveness*

TEI members continue to be highly concerned about the competitiveness of the Canadian tax system, particularly in view of U.S. tax reform, the proposed United States–Mexico–Canada Agreement, the imposition of import duties on steel and aluminum articles, and the uncertainty caused by the Federal Court of Appeal's Trans Mountain Expansion Project decision.[1]

The government's 2018 federal budget plan ("Budget 2018") expressly acknowledged the reality of U.S. tax reform and stated that, "[o]ver the coming months, the Department of Finance Canada [would] conduct detailed analysis of the U.S. federal tax reforms to assess any potential impacts on Canada."[2]

Since then, the Minister of Finance has indicated that the Department will release a fall budget update addressing a number of the concerns expressed by the business community relating to Canadian competitiveness. In particular, during a July 2018 interview with *Bloomberg News*, Minister Morneau indicated that the key themes of a fall budget update would include business taxation, oil pipelines, and renegotiation of the North American Free Trade Agreement.[3] And the following month, during a meeting with local business leaders in Windsor, Ontario, Minister Morneau stated:

> Our job as a government is to help more Canadians and more Canadian businesses succeed, and to grow the economy for the benefit of everyone. I know that the ongoing renegotiation of the North American Free Trade

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[1] *Tsleil-Waututh Nation v. Canada (Attorney General)*, 2018 FCA 153.

[2] Budget 2018, *Equality and Growth for a Strong Middle Class*, was tabled in the House of Commons by the Honourable William Francis Morneau, P.C., M.P., Minister of Finance, on February 27, 2018.

[3] *See* Theophilos Argitis, *Canada to Respond to U.S. Tax Reform Challenge in Fiscal Update*, Bloomberg, July 23, 2018, https://www.bloomberg.com/news/articles/2018-07-23/canada-to-respond-to-u-s-tax-reform-challenge-in-fiscal-update.

> Agreement, the recent tariff decisions by the U.S., and the potential impact of the U.S. tax reform are weighing heavily on business leaders across the country. That's why I'm listening carefully to what they have to say. Their collective experience will guide us as we respond to the immediate challenges while moving forward with our long-term plan to create more good, well-paying jobs, and strengthen and grow the middle class.[4]

TEI invites the Department to provide an update regarding the status of its review of the impacts of U.S. tax reform on Canada. Additionally, TEI would appreciate any insights that the Department could provide in relation to the fall budget update and, in particular, any potential measures being contemplated to increase the competitiveness of the Canadian tax system.

Without limiting the scope of this discussion, TEI would appreciate the Department's views with respect to the following recommendations that were made in a recently issued report by PricewaterhouseCoopers LLP, *The Impacts of US Tax Reform on Canada's Economy*:

(i) reducing the federal corporate income tax rate;

(ii) introducing a temporary 100-percent bonus depreciation allowance for equipment, structures, and acquired intangibles—including patents, trademarks, and copyrights;

(iii) enhancing Canada's scientific research and experimental development tax credit program; and

(iv) introducing an intellectual property (or "patent box") regime under which income from in-country developed intellectual property could benefit from a favourable tax rate.[5]

b) *Legislative Imbalance*

TEI believes that the statutory provisions governing the Minister of Internal Revenue (the "Minister") and large corporation taxpayers during the audit, objection, and appeal processes are inappropriately imbalanced in the Minister's favour.

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[4] Press Release, Dep't of Fin. Can., Minister Morneau in Windsor to Talk Competitiveness with Local Business Leaders (Aug. 13, 2018), https://www.fin.gc.ca/n18/18-070-eng.asp. At the time that TEI prepared these questions, the fall budget update had yet to be released.

[5] *See* PricewaterhouseCoopers LLP, *The Impacts of US Tax Reform on Canada's Economy* (Sept. 2018), https://thebusinesscouncil.ca/wp-content/uploads/2018/09/PwC-Final-Report-Impacts-of-US-Tax-Reform-Aug-2018.pdf.

The objection and appeal process for a large corporation taxpayer that disagrees with an assessment or reassessment made by the CRA is fraught with legislative traps for the unwary. First, the taxpayer's notice of objection must: (i) reasonably describe each issue to be decided; (ii) specify the relief sought in respect of each issue, expressed as the amount of a change in a balance or a balance of undeducted outlays, expenses, or other amounts of the corporation; and (iii) provide facts and reasons relied on by the corporation in respect of each issue. Second, a large corporation taxpayer's failure to completely satisfy each of these requirements can preclude the taxpayer from being able to appeal the assessment to the Tax Court of Canada. Furthermore, a large corporation taxpayer is required to pay 50 percent of the amount in dispute when assessed, with non-deductible interest accruing at 6 percent on the unpaid amount.

In contrast, the Canada Revenue Agency (the "CRA") is not subject to any statutory minimum standards of quality or completeness when issuing a notice of reassessment to a large corporation taxpayer. There are, however, express statutory provisions allowing the Minister to raise new issues at any point during the process and extend the reassessment period when taxpayers challenge requirements for information or compliance orders. Moreover, interest on refunds of excess amounts of tax collected accrues at only 2 percent and is fully taxable upon receipt by the taxpayer.

TEI welcomes a discussion of this acute legislative imbalance and invites the Department to share its views regarding the appropriateness, purpose, and utility thereof.

c) *BEPS Agenda & Interest Deductibility*[6]

Chapter 4 of the government's 2017 federal budget plan ("Budget 2017") provides that "[t]he Government remains firmly committed to protecting Canada's tax system, and has implemented—or is in the process of implementing—the measures agreed to as minimum standards under the BEPS project."[7] Budget 2018 reaffirmed the government's commitment to safeguarding Canada's tax system, noting that it has been an active participant in the BEPS project and "will continue to work with its international partners to improve international dispute resolution, and to ensure a coherent and consistent response to fight cross-border tax avoidance."

With respect to the final BEPS recommendations described as agreed "minimum standards," could the Department confirm whether, other than the need to complete the implementation process of previously announced actions, the government feels that it is fully compliant with all of its obligations in respect of those recommendations?

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[6] The term "BEPS" refers to the Organisation for Economic Co-operation and Development's ("OECD") Base Erosion and Profit Shifting ("BEPS") project.

[7] Budget 2017, *Building a Strong Middle Class*, was tabled in the House of Commons by the Honourable William Francis Morneau, P.C., M.P., Minister of Finance, on March 22, 2017.

Furthermore, with respect to certain BEPS action items, the aim of the final report was not to provide recommendations described as agreed "minimum standards" but rather to provide recommendations described as "best practices." What further action, if any, is the Department considering in relation to such "best practices"?

d) *The Digital Economy & Global Electronic Commerce*

TEI appreciates the cautionary and reflective approach that the Department has taken with respect to the taxation of the digital economy and global electronic commerce. At the same time, however, at least from an indirect tax perspective, a number of foreign and provincial jurisdictions are contemplating reactive measures to tax digital products and services. For example, the European Commission recently issued a proposed Council Directive that would impose a temporary three-percent tax ("Digital Services Tax" or "DST") on gross revenues from the supply of certain digital services, such as online advertising, digital intermediary activities, and the sale of data generated from user-provided information.

In the Government's Response to the Ninth Report of the Standing Committee on International Trade, *E-Commerce: Certain Trade-Related Priorities of Canada's Firms*, which was tabled in the House of Commons on April 26, 2018, the Minister affirmed that the Government of Canada is committed to maintaining a tax system that is fair and equitable for all Canadians. With respect to corporate income tax on a firm's profits, the Minister explained that generally accepted principles (or norms) of international tax policy provide that jurisdiction to tax is based not on the location of consumption but on where the productive activities by the firm which give rise to the underlying profits take place. Under these well-established norms, business profits of a non-resident corporation are taxable in a country only when the corporation has a physical presence in that country. The Minister added, however, that Canada is actively participating in a multilateral effort examining what updates may be required to those norms to reflect new digital business models.

TEI invites the Department to provide an update on the status of this multinational effort and discuss the nature of Canada's participation therein. In particular, TEI would appreciate learning the Department's views with respect to the OECD's interim report, *Tax Challenges Arising From Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, which was delivered to G20 Finance Ministers in March 2018.

e) *Proposed U.S.–Mexico–Canada Trade Agreement*

On September 30, 2018, Canada and the United States reached an agreement for Canada to join the latter's preliminarily agreed upon pact with Mexico to update and revise the North American Free Trade Agreement ("NAFTA") and to rename it the United States–Mexico–Canada Agreement ("USMCA"). TEI notes that the Limitation on Benefits articles of certain U.S. bilateral income tax treaties refer specifically to NAFTA. For example, subparagraph d) of paragraph 7 of Article 23 of the U.S.–U.K. Income Tax Convention, as amended, defines an "equivalent beneficiary" for purposes of the derivative benefits test as "a resident of a Member State of the European Community or of a European Economic Area state or of a party to the North American Free Trade Agreement" that meets certain other requirements. TEI invites the Department to comment on its views regarding the potential income tax treaty implications of ratifying the USMCA.

B. Carryover Matters and Follow-up Questions

1. *Form T4 Reporting and Regulation 102*[8]

This question follows up on question C.8 from our 2016 liaison meeting and question B.2 from our 2017 liaison meeting. At the 2016 meeting, the Department indicated that it would follow up with the CRA to obtain a more current view of the matter. At last year's meeting, the Department indicated that it would continue to monitor the Regulation 102 certification regime in concert with the CRA, but added that in the future, as the self-certification system matured, the Department might be willing to revisit the $10,000 Form T4 reporting threshold. TEI continues to recommend that this $10,000 threshold be increased and invites the Department to provide an update.

For ease of reference, TEI's questions and the Department's responses from 2016 and 2017 are reproduced in Appendix I.

DEPARTMENT OF FINANCE RESPONSE

The general objectives of Form T4 and the Regulation 102 certification regime are to ensure compliance and proper administration of the tax system. It is important to strike the right balance between those aims and the minimization of administrative and compliance burdens. As the regime is still relatively new, the Department believes that it is premature to make any changes at this time. Additional years of data are needed before the Department would consider changes to the Form T4 reporting threshold.

2. *Assessment of Part XIII Tax*

As discussed during our 2017 liaison meeting, subsection 227(10) of the Income Tax Act provides that the Minister "may at any time assess any amount payable . . . under Part XIII by a person resident in Canada," and, where the Minister sends a notice of assessment to that person, Divisions I and J of Part I of the Act apply.[9] Amounts paid or credited under Part XIII by Canadian residents on behalf of non-resident payees are not regularly assessed, however, meaning the normal statutory limitation period for making tax assessments ("reassessment period") under subsection 152(3.1) typically never begins to run. Accordingly, TEI requested

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[8] Unless otherwise indicated, all references to "Regulation" or "Reg." herein are to the current federal Income Tax Regulations, R.S.C., c. 945.

that the Minister be required by statute to issue an initial assessment for a Part XIII tax liability and subject to the normal reassessment period under subsection 152(3.1).

In response to our 2017 request, the Department indicated that it would be interested in receiving more information, including examples, and that recommendations on amendments distinguishing between a Canadian resident's obligations to withhold and remit tax and the non-resident's liability for the tax may be worth considering.

Because the Minister is not bound by the normal reassessment period in subsection 152(3.1), the Minister effectively has unfettered discretion to assess—or not to assess—a Part XIII tax liability. Canadian taxpayers, meanwhile, are left to suffer indefinite uncertainty with respect to such amounts, which raises serious fairness and practical administration concerns. The Minister's requirement to examine the taxpayer's income tax return and assess tax "with all due dispatch" coupled with the application of subsection 152(3.1) provide taxpayers critical certainty with respect to their tax liabilities and reporting obligations, while giving the Minister sufficient time to review and confirm their tax obligations. Although the Act provides that a Canadian-resident payor can seek indemnity from the non-resident payee, it establishes no boundaries for the CRA, which calls into question the fairness of the Act's administration as it relates to Part XIII tax. If the CRA decides to assess a Part XII tax liability, all taxation years are open and the Canadian resident could face potentially crippling interest under subsection 227(8.3) and penalties under subsection 227(9) on the total amount due.

In describing the policy rationale for statutes of limitation in the field of taxation, the Supreme Court of the United States noted early on that:

> Congress has regarded it as ill-advised[] to have an income tax system under which there never would come a day of final settlement and which required both the taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest. Hence *a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy*.

Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 301 (1946) (emphasis added). Consistent therewith, section 6501(a) of the U.S. Internal Revenue Code provides as a general rule that "the amount of *any* tax imposed . . . shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed)." (Emphasis added.) In the withholding tax context, therefore, the critical act that begins (or triggers) the statute of limitations on assessment of the withholding agent's tax liability is the filing of Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*.

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[9] 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").

TEI respectfully renews its request that the Minister be required, by statute, to issue an initial assessment for a Part XIII tax liability and subject to the normal reassessment period under subsection 152(3.1). A Part XIII tax liability must be treated no differently than a Part I tax liability, which the Minister is required to assess "with all due dispatch" or "within a reasonable time." As previously suggested, the assessment process could be handled efficiently through Schedule 29 reporting on Form T2, and the Minister's assessment could also encompass any Part XIII tax liability.

For ease of reference, TEI's question and the Department's response from 2017 are reproduced in Appendix II.

DEPARTMENT OF FINANCE RESPONSE

The Department expressed a need for concrete examples of arm's length situations where this has proved to be an adverse matter for Canadian-resident corporate taxpayers. In addition, the Department would appreciate other country comparatives, detail on commercial issues, and the effect on tax indemnities. The Department commented that the NR4 information slips filed with the CRA are not considered tax returns and do not provide enough information to facilitate the administration of the Act within the statute of limitations in subsection 152(3.1).

3. *Automobile Benefits*

This question follows up on question 7 from our 2012 liaison meeting and question 3.b from our 2013 liaison meeting. At those meetings, TEI noted that, under the CRA's assessing position described in Technical Interpretation 2011-039969117 (June 28, 2011), an employee might be considered to receive a taxable benefit equal to the full value of an employer-leased automobile where the automobile is (i) completely destroyed in a collision and (ii) self-insured by the employer. We understand that this treatment arises because, under the CRA's interpretation, a termination payment made by the employer to terminate the lease as a result of the accident would be included in the computation of an automobile standby charge under subsection 6(2).

As previously stated, TEI believes that this treatment can produce unintended consequences and is inconsistent with principles of sound tax policy. For example, two otherwise similarly situated employees of different employers could be considered to accrue substantially different taxable benefits where one employer self-insures leased automobiles and the other does not. Furthermore, due to the high value of many automobiles, an employee could be required to recognize significant taxable benefits that are disproportionate to the true benefit realized and, therefore, suffer financial hardship.

In response to Question 3b from our 2013 liaison meeting, the Department indicated that it was "aware of the issue and is reviewing, will discuss with [the] CRA, and formulate an appropriate position." TEI invites the Department to provide an update regarding the status of its review.

DEPARTMENT OF FINANCE RESPONSE

The Department repeated its response to this question from our 2013 liaison meeting. The Department recognizes the unfairness of the application of the Act; however, they remain of the view that a legislative amendment may not be required. The Department suggested that TEI first reach out to the CRA to consider its administrative position in these types of circumstances.

4. *Prohibited Investments*

This question follows up on question B.1 from our 2016 liaison meeting concerning the prohibited investment rules for Registered Retirement Savings Plans ("RRSP"), Registered Retirement Income Funds ("RRIFs"), and Tax Free Savings Accounts ("TFSAs"), which had been extended to retirement compensation arrangements ("RCAs"). Effective March 23, 2011, subsection 207.01(1) was amended to provide an excluded property exemption from the concept of "prohibited investments" for RRSPs, RRIFs, and TFSAs, but not for RCAs. At our 2016 meeting, TEI asked whether the Department would consider proposing an amendment to conform the prohibited investment for RCAs to the amended rules for RRSPs, RRIFs and TFSAs, with an effective date of March 29, 2012 (the date on which the prohibited investment rules were extended to RCAs). The Department responded that, in general, it made sense to have consistency among deferred compensation plans and that, in its ongoing review of tax rules, the Department would consider TEI's suggestion.

TEI invites the Department to provide an update regarding this matter.

DEPARTMENT OF FINANCE RESPONSE

As part of ongoing efforts to improve consistency of tax rules in respect of deferred income arrangements, Budget 2017 added Registered Education Savings Plans and Registered Disability Savings Plans to the Part X1.01 rules that apply to non-qualified investments and prohibited investments held by registered plans. As a next step, the Department is prepared to review the Part X1.3 rules applicable to investments held by RCAs and consider if greater consistency, where merited, should be sought with the rules applicable to registered plans, including the definitions of "prohibited investment" and "excluded property."

C. New Matters

1. *Large Corporation Collections Under Subsection 225.1(7)*

The CRA is generally precluded from collecting amounts of tax that are in dispute (e.g., assessed amounts for which the taxpayer has filed a notice of objection) until the dispute is resolved. If an amount of tax has been assessed in respect of a large corporation, however, subsection 225.1(7) of the Act permits the CRA to collect one half of the amount so assessed notwithstanding any objection.

Given the current administrative environment, which is characterized by an increasing volume of taxpayer objections and associated delays, large corporation taxpayers face an increasingly burdensome and costly hurdle to accessing the objections process. It is also unclear what purpose the rule in subsection 225.1(7) is intended to serve. Large corporations generally represent the most creditworthy class of taxpayers. Therefore, it does not appear intended to address creditworthiness concerns. Moreover, other provisions exist that could allow the CRA to advance collections actions in cases where taxpayer creditworthiness is a legitimate concern.

Considering the current economic climate and the observations above, what is the Department's view concerning the purpose of, and continued need for, subsection 225.1(7) as it applies to creditworthy large corporations?

DEPARTMENT OF FINANCE RESPONSE

The Department commented that this question had been asked in the past and that the Department has responded that it believes subsection 225.1(7) continues to serve a purpose. The Department is of the view that since the requirements to post security with the CRA have been relaxed (i.e., taxpayers no longer have to show hardship), doing so may be a valid alternative to paying 50 percent of the tax. The Department also indicated that the payment of 50 percent of the tax is an incentive to promote the resolution of an appeal. The Department asked TEI whether it considered the option to post security as viable. TEI responded that it costs more to post the security and the Letter of Credit (LOC) creates a liability on the balance sheet, which overall is a worse result than paying the cash. TEI proposed that a solution might be to make the 50 percent payable only after Appeals has confirmed the assessment.

The Department suggested that TEI could follow up with the Department on this issue regarding its proposal to change the payment point.

2. *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.

On July 3, 2018, the OECD released a non-consensus public discussion draft on financial transactions under Actions 8–10 of its BEPS Action Plan, *Aligning Transfer Pricing Outcomes with*

Value Creation.[10] The discussion draft addressed specific issues related to the pricing of financial transactions such as cash pooling arrangements and invited interested parties to comment thereon. TEI invites the Department to share its views regarding the cash pooling-related content of the OECD discussion draft.

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 Department be amenable to working with TEI and other stakeholders to develop a workable solution more in line with international tax norms?[11]

DEPARTMENT OF FINANCE RESPONSE

The Department recognizes that there are substantive and complex issues associated with cash pooling under the current tax rules governing cross-border financing arrangements. The Department is interested in taxpayer views, and would be willing to explore issues and options to develop workable solutions in this area.

3. *Inclusion of Adjusted Stub Period Accrual Under Section 34.2*

Under section 34.2 of the Act, a corporation generally must include in computing its income for a taxation year its "adjusted stub period accrual" in respect of a partnership in which the corporation has a significant (10-percent or greater) interest at the end of the last fiscal period of the partnership that ends with or within the corporation's taxation year.

Consider the following example with respect to variable "F" in the definition of "adjusted stub period accrual" in subsection 34.3(1): A corporation has a significant interest in a qualifying partnership with an adjusted stub period accrual for Year 1 comprising $100 of taxable capital gain (from a non-recurring income source) and $100 of business income.[12] A $50 variable "F" designation by the corporation in its return of income for Year 1 would reduce $25 of taxable

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[10] *See generally* Letter from James P. Silvestri, Int'l President, Tax Exec. Inst., to Tax Treaties, Transfer Pricing and Fin. Transactions Div., OECD/CTPA (Sept. 6, 2018) (commenting on the need for clear guidance from the OECD concerning many of the issues raised in the discussion draft, including the potential recharacterization of financial instruments, the proper interest rates on debt instruments, the treatment of guarantees and related fees, and the proper approach to captive insurance arrangements), https://www.tei.org/sites/default/files/advocacy_pdfs/TEI%20Comments%20-%20BEPS%20Actions%208-10%20Financial%20Transactions%20FINAL%20to%20OECD%206%20September%202018.pdf.

[11] TEI has posed the same question to the CRA.

[12] Variable "F" in the definition of "actual stub period accrual" in subsection 34.3(1) is an amount designated by the corporation in its return of income for the year and filed with the CRA on or before its filing due date for the year.

capital gain and $25 of business income. As a result, the corporation would include $75 of adjusted stub period accrual capital gain in Year 1 and then $75 of capital loss in Year 2, when the adjusted stub period accrual capital gain is reversed under subsection 34.2(4). The corporation would need to carry back the Year 2 $75 capital loss to Year 1 to offset the Year 1 $75 adjusted stub period accrual capital gain.

To avoid having to report a Year 1 actual stub period accrual capital gain and the associated capital loss carryback offset, the corporation could make a $200 variable "F" designation in its return of income for Year 1. Such a designation would eliminate both the taxable capital gain and the business income, but is likely to result in an excessive variable "F" designation and trigger application of the "income shortfall adjustment" provisions in section 34.3. This is a punitive result for the taxpayer.

A potential legislative solution would permit the taxpayer's variable "F" designation in its Year 1 return to target a specific character of income, such as taxable capital gains. If variable "F" in the definition of "adjusted stub period accrual" in subsection 34.3(1) were to permit designations based on character of income, a taxpayer could designate $100 of taxable capital gain as variable "F" and thereby eliminate the adjusted stub period accrual capital gain without impacting the taxpayer's business income accrual. A correlative amendment to the income shortfall adjustment provisions would be required to stream the income shortfall adjustment based on character of income. An alternative legislative solution would allow the taxpayer to elect to apply the Year 2 capital loss against any type of income in Year 2, irrespective of whether any taxable capital gain arises in that year. Would the Department be amenable to working with TEI and other stakeholders on a legislative solution in line with these suggestions?

An example illustrating this issue is provided immediately below.

Adjusted Stub Period Accrual ("ASPA") Example **Corporate Partner Taxation Year-end of Dec. 31**	**Year 1**		**Year 2**
Partner's Share of Mar. 31 Partnership Income that Ends in the Partner's Year:			
Business Income	133	(A)	120
Taxable Capital Gain (one-time disposition)	133	(B)	0
Mar. 31 Year-end Partnership Income (actual)	**266**		**120**
Current-year ASPA from Apr. 1 to Dec. 31 (computed based on March 31 fiscal year income realized * 275/365):			
Subsection 34.2(2) Inclusion	200		90
Variable "F" Designation Under Subsection 34.2(1)	50		0
ASPA net of Variable "F" Designation	**150**		**90**

Character of ASPA Amounts Pursuant to Subsection 35.2(5)			
Same character and same proportions as income and taxable capital gains allocated by partnership for fiscal periods that end with/within the partner's taxation year:			
Business Income	75	(A)	90
Taxable Capital Gains	75	(B)	0
ASPA for Apr. 1–Dec. 31 (days 275/365):			
Prior-year ASPA from Apr. 1 to Dec. 31 Deductible Under Subsection 34.2(4)			
Business Income	0	(A)	(75)
Taxable Capital Gains (Losses)	0	(B)	(75)
Reverse Prior-year ASPA for Apr. 1–Dec. 31	**0**		**(150)**
Total Partnership Income:			
Business Income {=sum(A)}	208		135
Taxable Capital Gains (Losses) {sum(B)}	208		(75)
	416		**60**

DEPARTMENT OF FINANCE RESPONSE

Two approaches are available to taxpayers: (1) formula; and (2) discretionary. Adoption of the discretionary approach is optional for the taxpayer. For the situation described, adoption of the formula approach would settle the issue identified. Taxpayers can already create a one-year deferral by controlling the timing of the disposition.

For example, depending on when the gain was incurred, the taxpayer may have already benefited from an entire year of deferral. In such a case, it is not clear that a deduction should be allowed. But the reverse could also happen, and the Department may be more sympathetic in that situation. However, because a legislative amendment could have unintended consequences on other types of income (e.g., such as small business, RDTOH) and could raise a series of technical issues, a complex legislative solution would be required to properly address the issue raised. The Department is not considering such an amendment at this time.

4. *Deduction of Utilities Service Connection Expense Under Paragraph 20(1)(ee)*

In computing a taxpayer's income for a taxation year from a business or property, paragraph 20(1)(ee) of the Act generally permits the deduction of "utilities service connection" expenses. As defined in paragraph 20(1)(ee), a utilities service connection expense is an amount paid by the taxpayer in the year to a person for the purpose of making a service connection to the taxpayer's place of business for the supply, by means of wires, pipes, or conduits, of electricity, gas, telephone service, water, or sewers supplied by that person. The CRA has interpreted this statutory definition to require that "the person receiving payment was the same person who supplied the [utility] service." Interpretation Bulletin IT-452, *Utility Service Connections* (Archived). TEI believes that this interpretation arbitrarily and unfairly restricts the ability of certain taxpayers from deducting their bona fide utilities service connection expenses, as illustrated below.

In certain provinces, the person receiving payment is often not the same person who can supply the utility service. In Alberta, for example, the Alberta Electric System Operator ("AESO") manages and operates the province's power grid. While individual utility companies own electrical generation, transmission, and distribution facilities, AESO supplies the electricity. The taxpayer pays the utility provider that owns the transmission system for the connection to the power grid and pays AESO for the supply of electricity. Since the person receiving payment for the utility service connection is not the same person who supplies the electricity, the requirement under paragraph 20(1)(ee) cannot be met, resulting in no deduction. In other provinces, such as British Columbia, Saskatchewan, and Manitoba, there is no distinction between the provider of the connection and the supplier of the utility service. In those provinces, a similar utility connection cost would be deductible under paragraph 20(1)(ee).

Furthermore, some taxpayers may pay a third-party contractor, rather than the utility service provider, for the service connection. If the taxpayer paid the utility service provider directly and the utility hired the contractor, the condition under paragraph 20(1)(ee) would be met. This "workaround" is often not practically available, however.

TEI believes that it is inappropriate to deny a deduction under paragraph 20(1)(ee) in circumstances where the supplier of the utility service does not (or cannot) perform the service connection function, or where a third party is contracted to make the necessary connection. Would the Department consider amending paragraph 20(1)(ee), perhaps by removing the words "supplied by that person," or issuing remedial administrative guidance to ensure the uniform and equitable treatment of taxpayers under the law in this context?

DEPARTMENT OF FINANCE RESPONSE

The Department recognizes that the practice of utility connection has evolved and changed from when the original legislation was enacted and, therefore, is open to considering the recommendation of an amendment to accommodate current practice.

APPENDIX I
Question and Draft Response from 2016 Liaison Meeting

[Question C.8] T4 Reporting and Regulation 102

Consistent with TEI representations made to the Department prior to Budget 2015, and prior to the related amendment of subsection 200(1.1) of the Regulations, we propose that the Reg. 102 Certification regime be revisited to align the relief from withholding tax with the exemption from T4 reporting under the 45/90 day test. Specifically, would the Department revise subsection 200(1.1) of the Regulations as follows?:

(1.1) Subsection (1) does not apply in respect of

(a) an annuity payment in respect of an interest in an annuity contract to which subsection 201(5) applies; or

(b) an amount paid by a qualifying non-resident employer to a qualifying non-resident employee that is exempted under subparagraph 153(1)(a)(ii) of the Act ~~if the employer, after reasonable inquiry, has no reason to believe that the employee's total amount of taxable income earned in Canada under Part I of the Act during the calendar year that includes the time of this payment (including an amount described in paragraph 110(1)(f) of the Act) is more than $10,000~~.

We note that this amendment would be revenue neutral to the amount of withholding tax collected, and would significantly reduce the administrative costs to both taxpayers and the CRA. TEI believes that this will also encourage additional participants in the Reg. 102 Certification regime. If the Department is unwilling to make this proposed revision, would it please explain the rational for the existence of the $10,000 T4 reporting threshold currently contained in paragraph 200(1.1)(b) of the Regulations?

DRAFT RESPONSE: The current requirements were developed after extensive consultation with various stakeholders, which included the CRA. The $10,000/T4 requirements were included because they were seen as reasonable balances of efficiency sought by certain stakeholders while also providing information that the CRA needs for its compliance purposes. The Department noted that in the future, as the self-certification system matures, it may be willing to revisit this requirement.

In a follow-up to the above response, a TEI member noted that in a very recent discussion with the CRA, its position on the need for this information for compliance purposes may in fact have changed and may now be supportive of removing this requirement. The Department indicated that it would follow up with CRA on obtaining a more current view on this matter.

Question and Response from 2017 Liaison Meeting

[Question B.2] T4 Reporting and Regulation 102

This question follows up on question C.8 from our 2016 liaison meeting. The Department of Finance indicated that it would follow up with the CRA to obtain a more current view of the matter. TEI would like to understand if there have been any developments regarding this matter.

For ease of reference, an abbreviated version of the 2016 question and the draft response are reproduced in the Appendix.

DEPARTMENT OF FINANCE RESPONSE

The Regulation 102 certification regime is still in its early stages. As such, the Department would want to proceed cautiously before considering a legislative amendment. We will continue to monitor this regime in concert with the CRA. In the future, as the self-certification system matures, the Department may be willing to revisit the $10,000/T4 requirement.

APPENDIX II
Question and Response from 2017 Liaison Meeting

[Question C.1] Part XIII Tax

Part XIII tax applies where a resident of Canada pays or credits a certain amount to a non-resident, requiring the Canadian resident to withhold and remit a 25-percent tax on amounts so paid or credited, unless that rate is reduced by an income tax treaty between Canada and the country of which the payee is a resident. Acceptance by the Minister of Finance (the "Minister") of the withholding tax amount and the subsequent reporting of that amount on Schedule 29 of an income tax return or receipt of the required NR4 notification does not trigger the commencement of a period to which a statute of limitations would apply.

Where the Canadian resident does not withhold and remit tax as required, the Canadian resident is liable for the unremitted withholding tax pursuant to subsection 215(6). Furthermore, subsection 227(10) provides that the Minister "may" assess the Canadian resident "at any time" an amount payable under Part XIII. Once an assessment is raised, Divisions I and J of Part I of the Act will apply, and with this assessment issued, section 152 will cause the normal reassessment period under subsection 152(3.1) to apply. Accordingly, amounts paid or credited under Part XIII by the Canadian resident on behalf of the non-resident payee are not regularly assessed and, therefore, the normal reassessment period never begins to run.

Under the Act, the term "assessment" means the determination by the Minister of the amount of a person's tax liability. The Minister is required to examine the taxpayer's return of income for the taxation year and assess tax for the year "with all due dispatch" or "within a reasonable time." Given that a Canadian resident is liable for any tax amounts determined under Part XIII, it is not reasonable that the Minister does not have an obligation to raise an assessment related to a Part XIII tax liability, regardless of whether the Minister agrees with the amount of tax withheld and remitted. The word "may" in subsection 227(10) allows the Minister to forego making a formal assessment in respect of any Part XIII tax liability. The Minister has full discretion not to assess tax unless the Minister determines that, upon review of the facts and the application of the law, an additional liability of tax is due. This is the only time when the Minister has a statutory duty to assess a Part XIII tax liability that would be subject to the normal reassessment period provided in subsection 152(3.1).

We request that the Minister be required by statute to issue an initial assessment for a Part XIII tax liability and be subject to the normal reassessment period under subsection 152(3.1). A Part XIII tax liability should be treated no differently than a Part I tax liability, which the Minister is required to assess "with all due dispatch" or "within a reasonable time." As an administrative solution, the assessment process could be handled efficiently through Schedule 29 reporting on Form T2 and the Minister's assessment could also encompass any Part XIII tax liability.

Without the Minister having an assessment obligation, tax liability under Part XIII can lead to tax uncertainty as well as possible inefficient and lengthy audit cycles. We welcome the Department of Finance's views on this proposal.

DEPARTMENT OF FINANCE RESPONSE

As the rule for no statute barring for Part XIII tax has in place for many decades, the Department would be extremely cautious as to any possible revisions.

Should TEI resubmit a question in the future on this matter, the Department would be interested in receiving more information, such as examples in which Part XIII had been reassessed by CRA beyond what TEI would consider to be a reasonable number of years, which would not have happened had a statute barring rule been in place. In addition, recommendations on amendments that may distinguish between a Canadian taxpayer's obligations to withhold and remit and the non-resident's liability for the tax may be worth considering.