TAX EXECUTIVES INSTITUTE, INC.

INCOME TAX QUESTIONS

Submitted to

CANADA REVENUE AGENCY

NOVEMBER 17, 2015

Tax Executives Institute welcomes the opportunity to present the following comments and questions on income tax issues, which will be discussed with representatives of the Canada Revenue Agency during the November 17, 2015 liaison meeting. If you have any questions about the agenda in advance of the meeting, please do not hesitate to call Lynn Moen, TEI's Vice President for Canadian Affairs, at 403.232.6430, or Grant L. Lee, Chair of the Institute's Canadian Income Tax Committee, at 604.641.2502.

A. Introduction

Question 1.

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

CRA Response:

Mr. Geoff Trueman was named Assistant Commissioner of the Legislative Policy and Regulatory Affairs Branch ("LBRAB") in October 2015. Prior to his appointment at the Canada Revenue Agency ("CRA"), Geoff was General Director of the Tax Policy Branch at the Department of Finance. Geoff began his career with the Government of Canada in 1992 when he joined the Department of Finance and since that time he has held a number of increasingly senior positions at the Department, as an economist and as an executive, in the areas of personal, sales, and business taxation, including a two-year deployment to the European Commission in Brussels.

Under his leadership, LPRAB will continue to strive to support the CRA in its broader mission to achieve excellence in program compliance and service delivery to all its clients. To this end, LPRAB will continue with its commitment to optimize the use of technology to enhance services and streamline operations, to enhance communication and engagement with our stakeholders, and to strengthen technical capacity and invest in the workforce of the future.

Specifically, LPRAB aims to ensure that Canadians have access to the services they need and to provide timely and accurate information in order to promote voluntary compliance. Each Directorate within LPRAB is building on established relationships with stakeholders to improve the accessibility and range of information products. The Branch will continue to collaborate with our stakeholders in an increasingly horizontal fashion (both within the CRA and also with industry and professional associations) to share knowledge and develop learning products to ensure that information is intuitive, searchable, and current.

To reiterate his predecessor's comments from last year – maintaining the ongoing relationship with TEI will continue to be a priority for LPRAB and the CRA.

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

Question 1. *Employer-Provided Social Events*

At the 2013 liaison meetings, TEI discussed with representatives of the CRA the current threshold for employer-provided social events. The CRA treats the cost of employer-provided social events that are available to all employees at a particular place of business as a nontaxable benefit, provided the cost per employee is reasonable, which is currently set at $100 per person. See ITTN-15 – Income Tax Technical News (December 18, 1998-cancelled).

As it has been 15 years since the interpretation was issued, taking into consideration:

a. Inflation: per the Consumer Price Index, $100 in 1998 is worth approximately $140 today;
b. Increase in automatic group gratuity charge, which is currently 18-20% for greater than eight people;
c. Increase in minimum wage for the food service industry; and
d. GST/HST/QST;

the $100 threshold in today's environment is too low and difficult for companies to administer in accordance with the current guidance.

In many cases attendance at employer-provided social events is mandatory or strongly encouraged. The benefit of the employer-provided social event is often for the employer as a whole to facilitate team building and cross-department networking.

After the 2013 liaison meeting, the CRA asked TEI to provide data points on current costs of providing social events. TEI responded to this request and we are waiting to hear from the CRA on its review and consideration of the sample case of costs.

We kindly request that the CRA provide an update on this review. TEI also recommends that the CRA increase the employer-provided social-events cost threshold to $200 per person to account for the rising costs of providing social events to employees, with any amounts above this threshold being treated as an employee-taxable benefit.

CRA Response:

In 2013, TEI recommended that the CRA revisit the $100-per-person guideline as a reasonable cost for an employer provided social event given inflation and automatically applied gratuities.

> **2013 DMCD Response – The CRA is open to this proposal but will not advance it without a business case. The TEI is invited to provide details that might support such a case.**

It is the CRA's long-standing position that an employer may provide a reasonable number of social events per year for employees, provided the cost per attendee (including employees' guests) does not exceed $100, exclusive of ancillary costs. Once the cost per person exceeds the threshold, the entire amount, including ancillary costs, is a taxable benefit to the employee.

While it is true that this policy has not been revised in a number of years, the fact that ancillary costs are not included when determining whether the threshold has been crossed means that certain inflationary pressures are already reflected in the policy. Furthermore, the fact that employers may host several events per year means that employees may already receive a significant non-taxable benefit for social (i.e. non-business) events in the year.

C. Administrative Matters

Question 1. *Employer-Requested Resolution*

Before 2007, CRA policy allowed large employers to pay employees' tax and interest resulting from taxable-benefit errors. These payments were originally called "Negotiated Settlements" and were renamed "Employer Requested Resolution" in 2001. This policy reduced administrative costs for both the CRA and the employers who wanted to compensate employees for these errors; the CRA avoided the cost of amending hundreds or thousands of T4s and reassessing T1s. Unfortunately CRA cancelled this policy, per Communication TSDMB-2007-113, Nov. 26, 2007, and an employer can no longer make a payment in lieu of amending employees' T4s. Would the CRA consider reinstating this policy?

CRA Response:

The CRA is responsible for promoting and enforcing compliance with Canada's tax laws, including an employer's obligation to correctly reflect salary, wages, and other remuneration paid to their employees on T4 slips, and ensure that the Employer has correctly withheld all necessary amounts. The employer-requested resolution policy was introduced to facilitate long-term voluntary compliance with these obligations but was discontinued when it became evident that this objective was not being realised.

In addition, underreporting employees' income may have long-term consequences for the employees: under-reported income and unallocated payments may potentially affect social benefit entitlements, such as CPP and EI, GST/HST credits, certain family-credits, as well as court-ordered spousal or child support arrangements, and have other impacts such as reducing the employee's RRSP or other pension contribution room.

Furthermore, an examination of this practise raised concerns that the absence of an assessment infringes on a taxpayer's right to raise objections.

Given that the CRA must balance employers' desire for administrative simplicity with our responsibility to maintain the integrity of the tax system for the benefit of all Canadians, the CRA is not considering reinstating this policy.

Question 2. *Voluntary Disclosures Program (VDP)*

The CRA offers taxpayers the opportunity to correct mistakes or deficiencies in reporting income on their tax returns under the Voluntary Disclosures Program. This program allows taxpayers to pay only taxes owed plus interest while avoiding the assessment of penalties and potential prosecution on the information accepted under the program.

a. General information request:

We respectfully request an update on CRA's decision-making process regarding voluntary disclosure files. In particular:

i. What should a taxpayer expect in a decision-making process, and who will be the decision maker in the following situations?

1. Eligibility for entry into the program
2. Technical matters associated with the file
3. Final number of years and interest, if any, to be assessed

CRA Response – 2a(i) :

The VDP officer will determine if the taxpayer meets the program's four criteria:

- Voluntary – the taxpayer has not been made aware of an audit, investigation, or any other enforcement action with respect to the information being disclosed
- Complete – the taxpayer has provided full and accurate facts for all taxation years or reporting periods where there was previously inaccurate, incomplete, or unreported income
- Penalty – the disclosure must involve the application, or potential application of a penalty
- One Year Past Due – the disclosure must include information that is at least one year past due

If the VDP officer encounters any technical matters when attempting to determine if a disclosure is complete, they refer the file to the appropriate program area for their opinion.

Taxpayers are required to demonstrate how they meet the four criteria under the VDP and provide evidence to support their disclosure submission. The VDP officer must be satisfied that the disclosure meets all four of the criteria, including the "complete" criteria as outlined in IC00-1R4 under paragraphs 35 to 37. In order for a submission to be considered complete the taxpayer must provide full and accurate facts for all taxation years or reporting periods where there was previously inaccurate, incomplete, or unreported income.

In addition to penalty relief, if a disclosure is accepted as valid, the Minister may grant partial interest relief for the years preceding the three most recent years of returns required to be filed up to but not beyond the previous ten years. The CRA does not have the legislative authority to relieve penalty or interest beyond the 10 years. However, the Federal Court of Appeal's decision in Bozzer v. Canada (2011) does provide the Minister with the discretion to waive or cancel interest that accrued within the last 10 calendar years, from the year the request for relief was made, regardless of the tax year in which the tax debt arose.

ii. Does the CRA decision-making process consider Red Tape Reduction initiatives and potential impacts on employer-employee relationship?

CRA Response – 2a(ii) :

VDP does consider Red Tape Reduction initiatives. For example, as of October 19, 2015, VDP began accepting submissions electronically through CRA's secure portals: My Account, My Business Account, and Represent a Client. However, the administration of taxes related to the remittance of payroll deductions, including CPP contributions, the EI premiums, and income tax fall within the purview of the CRA Compliance and Verification Branch.

b. The following is an example of a voluntary disclosure concern:

A corporate taxpayer with a unionized work force identifies a deficiency in the amount of taxable benefits assessed to employees in prior years. To correct for this, the corporation pays additional income tax, as well as CPP and EI remittances, both for the employee and employer contributions.

i. Can the CRA outline how the matter could be resolved without needing to involve the employees or report on their circumstances?

CRA Response – 2b(i):

In the situation described, the employer is essentially seeking an employer-requested resolution (ERR) through the voluntary disclosure process. ERRs were discussed in question C1.

As discussed above, CRA's responsibilities and the potential effect of under-reporting on the employee, do not permit these types of situations to be resolved without the necessary amendments to T4s and reassessment of employees' T1s; in other words, without the involvement of the employee.

Ultimately, allowing the employer to resolve the issue without the employee's knowledge takes away the employee's control of their own reporting process and may impact the employee's future benefits or entitlements without the employee's knowledge or permission.

ii. Would the CRA waive the requirement to file amended T4s if the employees have reached the maximum CPP- and EI-remittance requirements for the periods subject to voluntary disclosure?

CRA Response – 2b(ii):

The CRA does not waive the requirement to file amended T4s where CPP and EI maximum contributions have been reached. As outlined above, the impacts of incorrect statements on the employees' income are broader than just CPP and EI entitlements. Through the T4 amendment and T1 reassessment process, the employees' appeal/objection rights are maintained, and the provisions of the Income Tax Act and Regulations are respected. Additionally, this could lead to situations where some employees (those who have not reached the maximum CPP and EI) are reassessed and others are not, resulting in unfair, or unequal, treatment between taxpayers based on an arbitrary factor not supported by the legislation.

If an employer wishes to mitigate the impact of reassessments on employees, he or she may choose to pay the employees' tax liabilities once the reassessments have been issued. However, all parties should be aware that doing so results in a further taxable benefit to the employees in the year in which the payment is made, as is generally the case where the employer pays employees' personal expenses.

Question 3. *Large Business Compliance*

We respectfully request that the CRA provide an update on the Large File Case Program, including any changes in the executive leadership, risk assessment, and risk-profiling process, as well as the Large File Case Manager's span of control.

We also respectfully request the CRA's response to the following questions regarding its approach to Large Case Files:

a. Many taxpayers experience audit-scope levels that do not always reflect the rating received under the Approach to Large Business Compliance program. Is the CRA still following this program and, if not, how will the CRA conduct Large Business audits in the future?

CRA Response – 3a:

The CRA, and in particular the International and Large Business Directorate, continues to provide functional direction to the regions with respect to the domestic, international, and aggressive tax planning programs through the three divisions: Large Business Audit Division, International Tax Division, and Aggressive Tax Planning Division.

The Directorate also performs the competent authority function under Canada's tax treaties with respect to specific taxpayer requests through its Competent Authority Services Division.

There have been no changes in the executive leadership, except for the return of Marc Lacasse to his position as Director, International and Ottawa Tax Services Office. Gord Parr was appointed Director, Large Business Audit Division on December 2, 2015.

The CRA continues to focus on its risk assessment and risk-profiling processes to identify the highest-risk taxpayers nationally, to optimize its resources and technical capacity to address the most significant cases of non-compliance and, by extension, reduce the compliance burden for those that are lower risk, and deal with the CRA in an open and transparent manner.

More specifically, CRA is making enhancements to its Integrated Risk Assessment System that allow the Agency to consider risks in the large business population both at the economic-entity level and at the legal-entity level. The risks are further analyzed taking into consideration inherent and behavioural risks to determine an overall risk profile of the particular taxpayer. Those considered to be high risk will be subject to a full compliance audit.

New for the next fiscal year, the CRA is moving forward with the implementation of Integrated Large Business Audit Teams. In fact many offices already have the integrated teams in place. These teams will be led by an International Large Business Case Manager and will include domestic auditors along with specialty auditors who have knowledge of aggressive tax planning and international tax. Team size and structure will depend on the risk associated with the file/audit to be conducted. The benefits of the integrated audit teams include less compliance burden to the taxpayer and better service under the concept of "One Team, One Voice, One Audit." There will be:

- more informed and streamlined risk assessment,
- more comprehensive audit planning, and
- enhanced audit quality due to the consolidation of technical expertise within the team.

The CRA continues to follow its Approach to Large Business Compliance, which takes into account the taxpayer's and tax intermediary's compliance risks and promotes responsible corporate tax management behaviour. Historically the approach divided large businesses into three broad compliance risk segments: high, medium, and low. With the use of the Integrated Risk Assessment System, CRA is able review risk issues within each category.

When dealing with large businesses, the CRA conducts open and transparent discussions on the CRA's determination of their compliance risk and behaviour. Businesses considered to be high risk are subject to a full compliance audit. Taxpayers in the medium-risk category may be subject to a full-compliance or limited-scope audit, and taxpayers who are at low risk are subject to periodic compliance assurance reviews. In a limited number of cases, there may be a face-to-face Approach to Large Business Compliance meeting at the conclusion of the audit to address certain issues including the level of cooperation during the audit to establish a way forward for resolving contentious issues and to provide the taxpayer with earlier tax certainty. The Approach to Large Business Compliance strategy allows the CRA to focus its audit resources on the highest-risk cases of non-compliance within the large business population, and reduce the compliance burden for businesses that are low risk.

b. Many taxpayers often experience inconsistencies in audit approach because of case-file manager transitions, often including reversals of previously agreed courses of action, which leads to inefficiencies and delays. Will the CRA be addressing this issue and, if so, how?

CRA Response – 3b:

The CRA is updating its rotation policy to ensure that commercial awareness is maintained on the case while at the same time ensuring audit quality, integrity, and control. The rotation of International Large Business Case Managers having sufficient industry knowledge ensures commercial awareness and continuity of compliance activities with more than one case manager knowing the taxpayer's business activities. In addition, the rotation of the

International Large Business Case Manager fully supports the CRA's priority of maintaining integrity and security within its compliance activities. The CRA is implementing a new national audit case system that will facilitate the transfer of completed electronic audit files between rotating large business audit teams, and improve internal controls within the audit function.

c. Some large businesses understand that tax service offices from cities outside of the businesses' respective cities are now handling their audits, such as audits of Calgary-based businesses taking place in Edmonton or Winnipeg. How will such audits generally be conducted in the future and how will they address industry knowledge and experience of auditors, handling of audit queries, and data sharing and logistics for face-to-face meetings?

CRA Response – 3c:

As previously indicated, the CRA's Approach to Large Business Compliance ensures that the highest-risk cases nationally are addressed through enhanced risk assessment and leveraging capacity to thereby optimize CRA's resources. The distribution of compliance risk nationally can vary somewhat from year-to-year. In order to better align risk with resources and capacity, the CRA provides the regions the flexibility to move cases within the region and between regions in limited situations as part of workload portability to maximize resource utilization and audit results. Where there are more high-risk cases in one area that can be dealt with based on existing capacity, then the lower-risk cases within this high-risk category will be considered for workload portability, adhering to the principle that the receiving office has the industry knowledge and commercial awareness to undertake the audit. CRA will, however, examine over a multi-year period the distribution of large business audit resources with a view to better aligning resources and capacity with compliance risk.

Finally, the CRA is committed to minimizing the compliance burden as much as possible such that, where there is a need to examine the taxpayer records or conduct face-to-face meetings at the taxpayer's premises within Canada, the CRA will incur the travel costs for the audit team to attend at the taxpayer's location.

d. What are the CRA's goals for achieving currency in the audit-cycle process?

CRA Response – 3d:

The CRA's goal is to prioritize workload on a national basis to reduce the number of old, outstanding cases and maintain audit currency. As cases are completed or closed, the most recent taxation years filed and risk-assessed will be selected for audit based on risk. Audits will no longer be selected as a continuation from one year to the next. To start an audit of any taxation year, other than the most currently filed and risk-assessed, requires the approval of the Assistant Director of Audit of the local office.

Please note that cases involving high-risk issues will remain under audit until the non-compliance has been adequately addressed, notwithstanding our audit currency policy.

D. Audit Matters

Question 1. *Taxpayer Audits and Adjustments*

We understand the CRA currently has a quality-assurance program to review field audits for consistency and appropriateness. Would the CRA consider adopting a centralized quality-assurance program to streamline its transfer-pricing operations and audit procedures to ensure consistency on transfer-pricing issues for all taxpayers and appropriate support for (proposed) pricing adjustments, including technical and unbiased benchmarking support? If not, why not?

CRA Response:

At the CRA we have a number of checks and balances throughout our processes; some are mandatory, some are not. Our Continuous Program Integrity Review process is used to strengthen the integrity of all CRA international and large business audits. Through the Continuous Program Integrity Review process, completed audits are reviewed to assess general quality and adherence with legislation, policy, procedures, and program quality objectives. These reviews often identify opportunities for program improvement and the individual results are communicated back to senior management in the programs and regions for follow-up.

In addition to the Continuous Program Integrity Review of files that include transfer pricing transactions, the CRA has centralized international advisory services in the International Tax Division of the International and Large Business Directorate, to provide high-level and consistent technical support on some of our most material and complex transfer pricing cases. This centralization of technical support was specifically referenced in the 2008 Advisory Panel Report on Canada’s System of International Taxation as a best practice. In addition, the centralization of the Transfer Pricing Review Committee in the International Tax Division also ensures that the most senior technical staff, in conjunction with senior officials from Justice, Finance and the Aggressive Tax Planning Division, opine on both penalty application and re-characterization cases.

Question 2. *Regulatory Requirements and Transfer Pricing*

In highly regulated industries such as banking and securities, regulators in each jurisdiction closely monitor related-party transactions to ensure they occur at “fair market prices” so that appropriate revenues are attributed within their jurisdictions. Regulators may often stipulate the pricing arrangements in related-party transactions, which may be a condition for allowing these transactions to occur. Noncompliance with regulatory requirements may result in significant fines as well as the complete cessation of business operations. As regulators have the ability to restrict or close business operations entirely, taxpayers are very careful to comply with these regulatory requirements in all the relevant jurisdictions. Taxpayers can sometimes find themselves in situations where the transaction's arm's-length price, as otherwise determined outside the regulatory sphere, differs from the price stipulated by the local regulator. What is the CRA's position in these cases, and is the CRA willing to work with taxpayers to arrive at solutions that satisfy the arm's-length principle while still satisfying the regulatory requirements?

CRA Response:

CRA is not in a position to answer this question.

E. Technical Matters

Question 1. *BEPS Action 13*

On October 5, 2015, the members of the OECD's Centre for Tax Policy and Administration delivered its final recommendations for the BEPS project. We know that the Department of Finance and the CRA have been highly involved with the formation of some of the recommendations. We would like to hear the CRA's comments to the following questions:

a. As system changes and information- and documentation-gathering processes take time to implement, what is the timeline for implementing OECD BEPS Action 13, specifically its country-by-country reporting requirements and transfer-pricing documentation requirements? Can we expect changes in law or administrative guidance on methods of implementing these requirements? When can we expect such guidance and their associated effective dates?

b. What safeguards does the CRA expect to put in place to ensure confidentiality of information submitted to CRA pursuant to BEPS Action 13? Will there be limitations in the sharing of the information similar to those indicated by the IRS as indicated in the IRS' comment listed below?

* * *

Comment from the IRS

This was published in BNA in the form of a quote from an IRS official. BNA article Published July 21, TP report 304: CBC Reporting only for U.S. tax treaty partners.

July 21 — The U.S. is planning strict limits on the information that can be shared under the country-by-country reporting regime being developed under the OECD's base erosion and profit shifting project, an IRS official said.

Right now, the U.S. will exchange information only with its partners in treaties and tax information exchange agreements, said Karen Cate, a senior international tax law specialist in the office of the U.S. Competent Authority within the Internal Revenue Service.

Treaty and TIEA-based exchanges "will allow the United States to ensure that the information is used only for the intended and permitted purposes, and help us protect the confidentiality of commercially sensitive data," Cate said at a transfer pricing symposium sponsored by the National Association for Business Economics.

The U.S. wants to be sure the information will be used only for assessing high-level transfer pricing risks, BEPS-related risks and in some cases economic analyses, she said, stressing that "countries may not use the data as a substitute for detailed transfer pricing analyses of individual transactions."

* * *

c. Will the changes to information requirements under Canadian law resulting from BEPS Action 13 be limited to addressing the Action 13 requirements, or should we anticipate additional information requirements specific to Canada?

d. Has the CRA contemplated any potential Red Tape Reduction opportunities in order to partially offset the additional costs and compliance burdens resulting from the country-by-country reporting process? For example, would the CRA consider revising certain de minimis thresholds or contents of forms T106 and T1134? Would the CRA be willing to work with TEI to identify such Red Tape Reduction opportunities?

e. Has the CRA discussed with other tax authorities participating in the BEPS framework whether, in the interests of transparency and Red Tape Reduction, each tax authority should produce periodic public reports to show its progress against an agreed set of objective criteria related to the country-by-country reporting requirements? Such criteria could include measures taken to protect confidential taxpayer information under country-by-country requirements, measures taken to simplify existing tax-reporting requirements, additional volume of information collected under country-by-country requirements, additional CRA resources hired or required by CRA to handle country-by-country reporting reviews, or additional collected revenues attributed directly to country-by-country requirements. If not, would the CRA be willing to discuss adopting such measures on its own accord?

CRA Response:

The Department of Finance is the lead on BEPS.

Question 2. *Section 55 of the Income Tax Act*

Ordinary commercial structures typically include a parent corporation with a number of subsidiaries and sub-subsidiaries, both domestic and foreign. A common and prudent cash-management business practice is to move and manage cash within such a group by paying intercorporate dividends.

In the past, a Canadian company could confidently pay a Canada-to-Canada intercorporate dividend without the dividend being taxed as long as the transaction was truly an "inter-group" transaction, relying on the related-party exception of Income Tax Act subsection 55(3). A Canadian company could also rely on the "safe income" exception for this purpose. However, due to the complexity of the safe-income calculation and the long history of some subsidiaries, Canadian corporations typically have not incurred the time and expense of ascertaining a safe-income balance to support an intercorporate ordinary dividend.

We have heard informally that the revisions to section 55, which are intended to strengthen its anti-avoidance purposes, are not intended to require taxpayers to resort to share reorganizations followed by share redemptions in the place of ordinary course dividends. We have also heard that these revisions are not intended to tax intercorporate ordinary course dividends that cannot be established to derive from "safe income." However, TEI members remain concerned that, because all dividends result in a reduction of the fair-market value of shares held by the dividend payor and increase the cost of properties held by the dividend recipient, the CRA may try to reassess ordinary course dividends on the basis that a purpose of every dividend is a tainted purpose.

Can the CRA confirm its positions on these concerns for the record? Also, assuming the revisions to section 55 are not intended to apply to ordinary course dividends (and taxation of these ordinary course dividends that cannot be established to be from "safe income" will not occur), can the CRA comment as to whether the following scenarios would be ordinary course dividends?:

a. Paying dividends up a corporate chain to fund a parent corporation's dividend.

b. Paying dividends up a corporate chain to fund general corporate expenses such as servicing debt, funding growth, and repurchasing shares.

c. Paying dividends up a corporate chain to settle intragroup indebtedness resulting from centralized banking systems.

d. Paying dividends between corporations in a closely held group to facilitate intergroup loss utilization as previously sanctioned by the CRA.

Finally, what does the CRA consider to be "significant" in the context of applying proposed subparagraphs 55(2.1)(b)(i) and (ii)?

CRA Response:

A dividend is subject to subsection 55(2) if one of the purposes of the payment or the receipt of the dividend is to significantly:

- Reduce the gain on shares,
- Reduce the value on shares, or
- Increase the cost amount of property held by the dividend recipient.

Whether a reduction of gain or value or increase in cost is significant is a question of fact. The "significant" aspect could be measured in terms of an absolute dollar amount or on a percentage basis.

The determination of purpose is based on facts that are particular to the situation, including, but not limited to, the actions taken by the parties to the dividend and their motivation. In Ludco (2001 SCC 62), the Court was of the view that "in the interpretation of the Act, as in other areas of law, where purpose or intention behind actions is to be ascertained, courts should objectively determine the nature of the purpose, guided by both subjective and objective manifestations of purpose."

Although a dividend on a share would normally result in a reduction of value of the share, or an increase in cost of property of a dividend recipient, it's not the result that determines the application of proposed subsection 55(2.1). It's the purpose and the motivation behind the purpose that could be established by finding the answer to questions such as: "(i) What does the taxpayer intend to accomplish with a reduction in value or increase in cost?; (ii) How would such reduction in value or increase in cost be beneficial to the taxpayer?; (iii) What actions did the taxpayer take in connection with the reduction in value or increase in cost?"

Without limiting the application of the purpose test, a dividend that is directly or indirectly instrumental in the creation of an accrued loss on any share that may be used, or has the potential to be used, to shelter a gain on some other property provides an indication that the FMV reduction purpose exists (for example, one might consider transferring a property with an accrued income or capital gain to the corporation that issued shares that have an accrued loss).

Also, the use or possibility of using an increased cost amount of properties to shelter a gain is an indication that the purpose of the dividend is to increase cost.

Where a dividend is paid pursuant to a well-established policy of paying regular dividends and the amount of the dividend does not exceed the amount that one would normally expect to receive as a reasonable dividend income return on equity on a comparable listed share issued by a comparable payer corporation in the same industry, the CRA would consider that the purpose of the payment of such dividend is not described in proposed paragraph 55(2.1)(b).

In other circumstances, the purpose or absence of purpose can only be determined by a review of all the particular facts, and the question does not provide enough information to make such determination.

Although paragraph 19(h) of IC70-6R6 indicates that the CRA will not issue an advance income tax ruling in situations involving primarily a factual determination, the CRA will consider issuing a favourable opinion under proposed subsection 55(2) where all manifestations of purpose and corroborating circumstances support the absence of one of the purposes described in proposed paragraph 55(2.1)(b). The opinion would be conditional on the representation made by the taxpayer that the purposes for which the dividend was paid do not include one of the purposes described in proposed paragraph 55(2.1)(b) and on the completeness of the description of all the manifestations of such purpose and corroborating circumstances.

Question 3. *Schedule 33 – Taxable Capital Employed in Canada – Large Corporations*

With the elimination of the large corporations tax, a corporation that was neither a financial institution nor an insurance corporation no longer had to file Schedule 33. However, according to the Corporate Taxprep 2014 release notes, Schedule 33 must be filed for taxation years ending after December 31, 2013 if the total taxable capital employed in Canada of the related group is greater than $10 million. We are not aware of any explanation for requiring Schedule 33 in these circumstances, and the value of completing the form is not apparent to us. We request that the CRA reconsider its position on requiring Schedule 33.

CRA Response:

In the past, schedules 33, 34, and 35 were linked to the calculation of capital taxes. Once provincial and federal capital taxes were reduced to zero, the CRA stopped receiving these forms.

We continue to need the information from these schedules to validate the small business deduction amount allowable (limited to large corps who are CCPCs), as well as to calculate any applicable section 235 penalties that may apply (applicable to all large corporations).

Accordingly, we have made the following changes:

For tax years 2014 and beyond, we have replaced this bullet on the form:

- If you are filing a provincial capital tax return with your T2 Corporation Income Tax Return, also file a completed Schedule 33 with the return no later than six months from the end of the tax year.

With this one:

- If the total taxable capital employed in Canada [TCEC] of the corporation and its related corporations is greater than $10,000,000, file a completed Schedule 33 with your T2 Corporation Income Tax Return no later than six months from the end of the tax year.

The T2 return was also modified to show that schedules 33, 34, or 35 are required if a positive response is given to question 233. Accordingly, as of April 2015, our assessors will contact corporations who do not file the appropriate schedule when they report their TCEC is over $10M.

Question 4. *Gift Certificates*

The CRA has an administrative policy that exempts non-cash gifts and awards given to employees as taxable benefits in certain circumstances. Gift certificates, however, are excluded from this administrative policy exemption. As a result, employers often avoid giving gift certificates to their employees because of the associated tax liability to the employees. There is little difference between an employee receiving a gift directly from his or her employer and an employee purchasing that same gift with a gift certificate from the employer. We believe that gift certificates, particularly those from a named vendor or service provider that are not redeemable for cash, should be included in the administrative policy exemption. This would not frustrate the exemption's intent. Furthermore, the definition of "excluded gift" and "excluded award," which does not include gift certificates, in Subsection 37.1.5 of the Quebec Tax Act sets a precedent for this position. Would the CRA similarly consider exempting vendor- or service provider-specific gift certificates in the same manner as it does for non-cash gifts and awards?

CRA Response:

The CRA has a gifts and awards policy that allows employers to recognize certain personal and professional milestones in their employees' lives. Rewards for good work are not included in the gifts and awards policy and would be considered a taxable benefit.

The gifts and awards policy allows an exemption of up to $500 for non-cash gifts or awards, provided that the reason for the gift or award is consistent with the definitions contained in the policy. Cash and near-cash items, such as gift certificates, are not included in the policy, and therefore not eligible for the exemption.

The CRA's policy does allow vouchers. A voucher allows the employee to exchange it for a specific, pre-determined item. Therefore, where an employer provides an employee with a voucher for a specific item at a specified vendor, and the value of the item is below $500, it would meet the administrative exemption for non-cash gifts and awards, provided all of the other policy criteria are satisfied as well.

TEI asked about the difference between an employer purchasing a particular item for an employee from a store and giving the employee a gift certificate so that he or she can go to the same store and obtain that same item.

Given the broad variety of products that may be available from a single service provider (Amazon, a mall, department store) a gift certificate offers vast choice. For purposes of the gifts and awards policy, CRA considers a gift certificate to be near-cash because it essentially functions as cash.

Question 5. *Certificates of Residency*

To eliminate or reduce the withholding requirements on international payments, taxpayers must often provide foreign tax authorities or foreign business partners, such as their customers, with proof of Canadian residency status, per the relevant tax treaty. This is an annual requirement and, for taxpayers with extensive international business activities across numerous countries, may involve numerous requests. The CRA has made progress in centralizing the production of certificates of residency and streamlining the Canadian partnership certificate-of-residency process. However, a standard request may still take eight to ten weeks or longer during peak periods. A more complex request, such as a partnership request, may take even longer. In one instance, it took several months for the taxpayer to receive a response to the request even though the taxpayer provided the information as noted on the CRA website. This delays collections from foreign customers who use it as a convenient excuse to delay payments.

a. As international business arrangements and transactions tend to remain in place for many years, would the CRA be willing to establish an automatic annual renewal process for certificates of residency?

CRA Response – 5a:

In order to issue a Certificate of Residency, the residency of the requestor must be determined based on the information available to the CRA at the point in time of that request. Since this information may change in following years, the CRA will continue to maintain the annual requirement.

b. Would the CRA consider setting up a certificates-of-residency specific "help line," as opposed to the general business enquiries hot line, to assist taxpayers in expediting the processing of these requests and avoid costly delays in collecting amounts owing?

CRA Response – 5b:

Certificates of Residency are processed on a first-in, first-out basis. Although such things as missing information or excessive volumes may impact the processing timeframe, the majority of these requests are completed in a timely manner. The CRA maintains general processing timeframe information which is updated weekly. Once the timeframe has elapsed, an enquiries agent may be contacted to follow-up with the Regional Correspondence Centre who will then contact the taxpayer or representative within a specified timeframe, usually within two business days.

c. Can the CRA confirm whether the taxpayer services regional correspondence centres are still the appropriate place to submit certificate requests, or has the CRA changed where these requests should be sent?

CRA Response – 5c:

Yes, the Regional Correspondence Centres are where these requests should be sent. An additional question was raised during the meeting relating to engaging Large Case File Managers to streamline this process for large corporations. Consultations were held with Compliance Programs Branch to determine the feasibility of Large Case File Managers participating in the review of the certificates of residency. As Large File Case Managers are normally conducting audits for prior years and not the current year, it is not practical to involve auditors in the process.

d. Many of our treaty partners have their own certificate-of-residency templates and procedures, which can require formal notarization of original-signed documents, certification from a foreign embassy or consulate, and, in some instances, an official translation. Because this process is time consuming and repetitive, TEI welcomes the CRA's views on whether Canada's treaty partners would be open to standardizing the annual certification process and coordinating a redesigned certificate of residency containing all of the information necessary to expedite issuing certificates of residency and meeting all foreign jurisdictions' requirements for applying the reduced treaty withholding rate. We suggest this issue could be a good item to address at the

OECD BEPS Action 15 ("Develop a multilateral instrument") discussion scheduled for next year.

CRA Response – 5d:

The CRA appreciates the difficulty that taxpayers may experience in obtaining and furnishing certificates of residency in order to obtain treaty benefits. The CRA, through its competent authority functions under Canada's tax treaties, works with our treaty partners in order to reduce this burden where possible. We have seen some success so far, such as increased acceptance of Canadian certificates of residency and a reduction in the need for legalization. The CRA will continue this work as specific instances of difficulty are brought to our attention. In addition, and where appropriate, the CRA will continue to advocate for a reduced need for certificates of residency in order to obtain treaty benefits. However, it is important to note that there is great variety in the tax and legal systems of the world, as well as countries' official language needs. These potentially irreconcilable differences would make international standardization of certificates of residency and related processes a very difficult and time consuming undertaking.

As explained in the OECD BEPS ACTION 15: 2015 Final Report, Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, the countries participating in the OECD-G20 BEPS Project have agreed to establish an ad hoc Group to develop a multilateral instrument to modify tax treaties. The specific mandate of the Group is to "develop a multilateral instrument to modify existing bilateral tax treaties solely in order to swiftly implement the tax treaty measures developed in the course of the OECD-G20 BEPS Project." The Group has the ambitious goal to conclude this work and open the multilateral instrument for signature by December 31, 2016. Since the standardization of certificates of residency was not a tax treaty measure developed in the course of the OECD-G20 BEPS project, it is not a topic that will be addressed by the Group for inclusion in the multilateral instrument.

Question 6. *Back-to-Back Loans – Notional Pooling Arrangements*

Does the following fact pattern implicate a "specified right" under Income Tax Act subsection 18(5)?

Multinational corporate groups often enter into "cash pooling" arrangements with financial institutions to efficiently manage cash balances. Cash pooling arrangements typically fall into one of two categories: physical and notional. Under a physical cash pooling arrangement, a master or "header" account is typically held by a member of the corporate group with the financial institution. Each participant in the pooling arrangement has a subaccount linked to the master/header account. Cash balances in the subaccounts are transferred to the master/header account on a daily basis thus creating an intercompany loan owing to the participant by the master/header account holder. Balances in the master/header account are transferred to the subaccounts from time to time to meet the cash requirements of the participants.

Under a notional cash pooling arrangement, participants have separate bank accounts with the same financial institution and retain their cash balances or incur overdraft balances directly with the financial institution, as opposed to transferring cash to a header/master account. Each participant earns deposit interest and incurs overdraft interest on its respective account balance, but the rate of overdraft interest charged to a participant is typically reduced to match the deposit interest rate to the extent the aggregate balance of the participating accounts is positive.

Additionally under notional cash pooling arrangements, financial institutions often require participants to grant the institutions the right to formally offset overdraft balances in pool accounts against deposit balances in other pool accounts. In the absence of the ability to set-off overdraft balances in this manner, the financial institutions could be required to treat the overdraft balances as non-performing loans for regulatory purposes.

For example, suppose that Canco, a Canadian-resident corporation, is a wholly-owned subsidiary of Parentco, a non-resident corporation that has a number of other wholly-owned subsidiaries not resident in Canada and that operate in various jurisdictions. Parentco and its other subsidiaries, including Canco, have a notional cash pooling arrangement that has been established with an arm's-length financial institution (the "Bank") not resident in Canada. Under the relevant pooling agreement, the Bank has the right to offset overdraft balances of any pool participants against deposit balances of other pool participants without prior notice. Canco has an overdraft balance on its pool account and has overdraft interest charges owing to the Bank.

As this fact pattern may implicate taxation of non-residents, does the Bank's right to offset the deposit balances of other pool participants against Canco's overdraft balance constitute a "specified right" within the meaning of subsection 18(5)?

CRA Response:

Notional cash pooling arrangements of the type you have described raise issues both in respect of the thin capitalization rules and the non-resident withholding tax rules. The concept of a "specified right," which is the main focus of your question, is relevant in the application of the new "back-to-back loan" rules contained in section 18, in respect of thin capitalization, and in section 212, in respect of non-resident withholding tax.

In the circumstances you have described, it is the CRA's view that the deposit balances of the non-resident pool participants would be considered "intermediary debts" for the purposes of subparagraphs 18(6)(c)(i) and 212(3.1)(c)(i), with the result that the back-to-back loan rules would be engaged, provided its other conditions are met. We find support for this position both in the text of the law as well as in the Department of Finance Explanatory Notes accompanying the bill that enacted these "back-to-back" loan rules, which contain an example that seems to us to be exactly on point.

The "specified right" concept represents an alternative means of engaging the back-to-back loan rules. In light of our view that such notional cash pooling arrangements would be caught under subparagraphs 18(6)(c)(i) and 212(3.1)(c)(i), it is not necessary to consider the possible application of the specified right rules contained in subparagraphs 18(6)(c)(ii) and 212(3.1)(c)(ii).

Question 7. *U.S. Donations*

Article XXI(7) of the Canada-U.S. Tax Convention permits a Canadian corporation to take a donation deduction against its U.S.-sourced income when the Canadian corporation makes a donation to a U.S. charitable organization. Can the CRA clarify the definition of U.S.-sourced income for this purpose? For example, can U.S.-sourced capital gains qualify?

If the Canadian corporation has no U.S.-sourced income for the year in question, does a carryforward system exist, and if so, how long is it? As Schedule 2 on T2 makes no mention of U.S.-bound donations, what would be the mechanism for disclosing such a donation and claiming a corresponding deduction in the corporation's tax return?

CRA Response:

Paragraph 110.1(1)(a) of the Income Tax Act (the "Act") permits a corporation to deduct in computing its taxable income for a particular taxation year the eligible amount of a gift made by the corporation to a registered charity in that year, or in any of its five preceding taxation years, to the extent that amount was not previously deducted. Under the Canada-U.S. Income Tax Convention (the "Treaty"), a gift made by a corporation to a U.S. resident organization described in paragraph 7 of Article XXI ("a Qualifying U.S. Charity") of the Treaty is deemed under that paragraph to be a "gift to a registered charity" for purposes of the Act and is subject to the same general limitations as donations to Canadian registered charities, but on the assumption that the corporation's income only included its income arising in the U.S. (i.e. income from U.S. sources).

A. Your first question asks us to clarify what the meaning of U.S.-sourced income is for these purposes and, in particular, whether U.S.-sourced capital gains would qualify.

The Treaty does not assign a specific meaning to the expression "arising in" for the purposes of paragraph 7 of Article XXI, i.e., it does not specify how to determine the source of income. The CRA's view is that unless a specific meaning is given to that expression in the relevant Treaty provision, such as in Article XXIV (per its paragraph 3) and Article XI (per its paragraph 4), Canadian domestic sourcing rules should be used. These sourcing rules are generally set out in Folio S5-F2-C1, Foreign Tax Credit, under the heading "Determination of the location of a source of income."

For the purposes of paragraph 7 of Article XXI of the Treaty, the CRA's view is that "income" includes the taxable portion of a capital gain. Thus, if in a particular taxation year the corporation has a capital gain that is considered to have a U.S. source (see paragraphs 1.62 to 1.65 of the above-mentioned folio), the taxable portion thereof would be considered "income arising in the United States" in that year for the purposes of paragraph 7 of Article XXI.

B. Your second question asks whether there is any ability to carry forward amounts of gifts made to a Qualifying U.S. Charity that are not deductible because of the U.S.-source income limitation.

It is the CRA's view that the eligible amount of such gifts may be deducted by the corporation, generally up to 75 per cent of its income from U.S. sources, and that the five-year carryover rule in paragraph 110.1(1)(a) of the Act equally applies to gifts made by the corporation to a Qualifying U.S. Charity.

C. As for your third question, there are no special T2 filing instructions with regard to claiming gifts made by a corporation in a particular taxation year to one or more Qualifying U.S. Charities. Such gifts should be reported in the same manner as gifts to a Canadian registered charity. However, to support a paragraph 110.1(1)(a) deduction claimed in a particular taxation year for gifts to Qualifying U.S. Charities, the corporation should prepare a statement indicating the gifts to Qualifying U.S. Charities and the amount of its "income arising in the United States" for purposes of paragraph 7 of Article XXI. This statement does not need to be filed with the T2 return but the corporation should keep it in case we ask for it later.

Question 8. *Scientific Research and Experimental Development (SR&ED) Tax Incentive Program*

The CRA recently attempted to clarify various SR&ED issues while stating that it was not changing its SR&ED policies. One of the changes to come out of this process was the Eligibility of Work for SR&ED Investment Tax Credits Policy ("Eligibility Policy") that introduced subtle policy changes despite overall claims to the contrary. Because of the Eligibility Policy, some Research and Technology Managers and Advisors have since determined there to be no eligible SR&ED in many claims due to a lack of scientific or technological advancement, or a lack of scientific or technological uncertainty at the lowest, underlying technological levels. These projects are therefore considered to be "routine" or "standard practice" and not eligible for SR&ED tax benefits even though they were previously SR&ED-eligible. The determinations are often inconsistent with the policy and result in some taxpayers receiving tax credits while others do not, despite the same or similar circumstances.

CRA Response:

According to TEI's memo, the CRA's Eligibility Policy has "…introduced subtle policy changes despite overall claims to the contrary …," and the arguments and questions put forward by TEI are related to specific concepts and wording that were in the old eligibility policy document, "Information Circular 86-4R3," which was removed from the CRA website after the policy consolidation project was completed in December 2012.

Before we address the questions related to IC 86-4R3, we would like to provide some general comments related to the Eligibility Policy, which will give some context to our ensuing responses.

1. It is very important to the CRA that businesses are able to access the SR&ED program as easily as possible so that they can receive the research and development (R&D) support they need to remain competitive in a global business environment. When the CRA began the policy consolidation project, there were over 71 documents that explained the program's eligibility requirements (science and financial). We wanted to make it easier for businesses to navigate the program so we undertook a project to consolidate and clarify all the information. We did extensive online and in-person consultations with stakeholders (e.g. businesses, tax preparers, associations) to make sure that the end products would be helpful to businesses to better understand the eligibility requirements. The intent of the policy consolidation project was never to change SR&ED policy.

2. One of the end products was the Eligibility Policy—a single document that explains the program's science eligibility requirements. The objective of the Eligibility Policy was to provide businesses with a clear and consistent explanation of what "SR&ED" is. The information in the document is intended to help businesses more easily self-assess and determine if their work may be eligible for the SR&ED investment tax credit.

3. The guiding principles of the policy consolidation project were to clarify the concepts, update the information by taking into account case law, and eliminate redundant or obsolete information. Within this context, we realized that the same core concept was explained in "subtly different" ways in several of our old policy documents. Therefore, after consolidating and streamlining the information, it may appear that the removal of "subtly different" wording is tantamount to a change in policy, even though the concept has not changed. This point is further illustrated in our responses below.

4. We also realized that many of our old policy documents contained information related to operational procedures (that is, how to conduct a review), which we felt was not relevant in a policy document. Therefore, we removed any information about

operational procedures from the Eligibility Policy, and instead, incorporated this information into the claim review manuals.

5. Since the publication of the Eligibility Policy in December 2012, we have received feedback on the policy from various stakeholders. We have reviewed and considered all the feedback, and as a result, with the aim of making it more clear, we have made noticeable changes to the document in the April 2015 version.

6. The CRA is always open to receiving feedback from stakeholders to improve any of the SR&ED policy documents. If TEI has specific suggestions to improve the wording of the Eligibility Policy so that the concepts are more clear, we encourage TEI to forward their suggestions to the SR&ED Directorate Headquarters (HQ) for consideration.

7. Consistency in how SR&ED claims are reviewed and the eligibility decisions rendered is very important to the CRA, and over the last several years we have implemented a number of measures to improve consistency. For example, we

   i. published claim review manuals to make sure claims were reviewed the same way across the country,
   ii. implemented a national training program for our science reviewers to make sure that the policies and procedures are consistently understood and applied,
   iii. redesigned the SR&ED Quality Assurance program to better enable HQ to identify and address any areas of inconsistency, and
   iv. implemented "consistency reviews," where a sample of closed files in a specific industry sector is examined by HQ to determine if the science eligibility decisions are correct and consistent across the country.

a. Criterion of Scientific or Technological Uncertainty

During the SR&ED clarification process, the CRA consolidated Information Circular (IC) 86-4R3 into the new Eligibility Policy paper, the former of which had been a widely accepted authority on SR&ED matters. For example, in the case *Northwest Hydraulic Consultants Ltd. v. The Queen*, [1998] 3 C.T.C. 2520, Judge Bowman referred to IC 86-4R3 as a generally useful document because it was jointly developed by industry and the CRA, stating specifically, "It represents a broad consensus of persons in the public and private sector who are likely to be affected by or to have an interest in the interpretation of the SRED provisions of the Income Tax Act." *Id*.

IC 86-4R3 had provided the SR&ED criterion of scientific or technological as follows:

"Whether or not a given result or objective can be achieved, and/or how to achieve it, is not known or determined on the basis of generally available

> scientific or technological knowledge or experience. This criterion implies that we cannot know the outcome of a project, or the route by which it will be carried out without removing the technological or scientific uncertainty through a program of scientific research or experimental development.
>
> "Specifically, scientific or technological uncertainty may occur in either of two ways:
>
> - it may be uncertain whether the goals can be achieved at all; or
> - the taxpayer may be fairly confident that the goals can be achieved, but may be uncertain which of several alternatives (*i.e.*, paths, routes, approaches, equipment configurations, system architectures, circuit techniques, etc.) will either work at all, or be feasible to meet the desired specifications or cost targets, or both of these."

This criterion is not specifically listed in the new Eligibility Policy. Please confirm that a project meeting this definition of scientific or technological uncertainty still meets the definition of SR&ED as defined in Section 248(1) of the Income Tax Act.

CRA Response – 8a:

With respect to **scientific or technological uncertainty**, the current version of the Eligibility Policy states:

> *"Scientific or technological uncertainty means whether a given result or objective can be achieved or how to achieve it, is not known or determined on the basis of generally available scientific or technological knowledge or experience. Specifically, it is uncertain if the goals can be achieved at all or what alternatives (for example, paths, routes, approaches, equipment configurations, system architectures, or circuit techniques) will enable the goals to be met based on the existing scientific or technological knowledge base."*

Comparing the paragraphs from IC 86-4R3 and the current Eligibility Policy, we believe that the essential concept from the IC has been captured in the policy. It is to be noted that the second paragraph in the IC refers to the circumstance under which a technological uncertainty **may** exist whereas the current policy clarifies the same concept further by including reference to scientific or technological knowledge base.

Moreover, it is important to reiterate here that meeting the requirement of scientific or technological uncertainty does not necessarily mean the work is "SR&ED."

Considering that the concept from the IC has already been captured and clarified, we do not think that there is a need to provide further clarification. However, if TEI has specific examples that they would like to be considered in order to better illustrate and understand the concept of scientific or technological uncertainty in the Eligibility Policy, TEI is encouraged to contact the SR&ED Directorate (HQ) and bring forward their examples for consideration.

b. The Baseline from Which to Measure Technological Uncertainty

Second, IC 86-4R3 also discussed application of SR&ED-eligibility criteria in a way not specifically addressed by the Eligibility Policy. Section 2.11 of IC 86-4R3 had stated,

> "The technical uncertainties encountered by one taxpayer may well be looked upon as facts easily obtained by another. The judgement as to eligibility should be made within the context and environment of a single company and its field of business. Specifically, the activities undertaken to resolve technical uncertainties are eligible if the taxpayer cannot obtain the solutions through commonly available sources of knowledge and experience in the business context of the firm."

Section 2.13 of IC 86-4R3 had elaborated further on "experimental development" by stating that in order to be SR&ED eligible "it must seek to advance the taxpayer's technological knowledge base. The technological advance achieved only needs to be slight."

Please confirm that when a taxpayer cannot obtain solutions through commonly available sources of knowledge and experience in the business context of the firm, then its activities associated with resolving these technological uncertainties still meet the definition of SR&ED as defined in Section 248(1). Is the baseline for measuring the technological uncertainty faced by a taxpayer specifically the taxpayer's baseline, which includes information available to the taxpayer?

CRA Response – 8b:

The current version of the Eligibility Policy states:

> *"With respect to the five preceding questions,* ***consideration must be given to the scientific or technological knowledge base and the business environment of the individual company.*** *Business environment characteristics include business size, competition, area of industry, and access to technical resources. It is expected that any company making a claim for SR&ED will have or will access the expertise necessary to carry out that work."*
>
> and
>
> *"The company is expected to have information that is common knowledge at the time the work is performed.* ***Common knowledge is knowledge available to professionals familiar with the specific areas of science or technology in question ...."***

The **Glossary defines scientific or technological knowledge base** as:

> ***"Scientific or technological knowledge base refers to the existing level of technology and scientific knowledge, and consists of the knowledge of the resources within the company and sources available publicly***.
>
> *"The resources within the company include:*
>
> - *technical knowledge, education, training, and experience of its personnel; and*
> - *its technical capabilities typified by its current products, techniques, practices, and methodologies (for example, trade secrets and intellectual property).*
>
> *"Publicly available sources generally include scientific papers, journals, textbooks, and internet-based information sources as well as expertise accessible to the company (for example, through recruiting employees or hiring consultants or contractors). The company is expected to have information that is common knowledge at the time the work is performed. Common knowledge is knowledge available to professionals familiar with the specific areas of science or technology in question.*
>
> *"It is recognized that, although the knowledge available publicly is the same for all companies, the scientific or technological knowledge base may vary from company to company because the internal resources can vary from company to company."*

The idea of "commonly available sources of knowledge or experience in the business context of the firm" is covered under the concept of scientific or technological knowledge base in the Glossary. And comparing the paragraphs from IC 86-4R3 and the current Eligibility Policy, it is clear that the essential concept [*that the determination of eligibility must take into consideration the business environment/business context of the company*] has been captured in the Eligibility Policy. Therefore, considering that the concept from the IC has already been captured we do not think that there is a need to provide further clarification to describe the baseline from which to measure technological uncertainty.

Moreover, the problem with this concept as expressed in the IC is that it equates the work to resolve a scientific or technological uncertainty with meeting the definition of SR&ED. However, the fact is that the existence of an uncertainty is only one of the requirements—the work still has to be a systematic investigation or search involving the formulation of a hypothesis.

c. Interpretation of "Standard Practice"

Third, IC 86-4R3 specifically interpreted when a "standard practice" might lead to SR&ED ineligibility, but the Eligibility Policy is not so specific. Section 4.2 of IC 86-4R3 had stated, "Standard practice refers to directly adapting a known engineering or technological practice to a new situation when there is a high degree of certainty that the known technology or practice will achieve the desired objective." IC 86-4R3 had gone on to state in section 4.3, "In other words, if the project involves directly adapting a known technology to a new situation, when it is reasonably certain that the approach will work, it is ineligible."

Please confirm that a standard practice used in experimental development without a high degree of certainty that the known technology will achieve the desired objective, or when it is not reasonably certain that the approach will work, continues to qualify as technological uncertainty and therefore meets the definition of SR&ED as defined in Section 248(1).

CRA Response – 8c:

"Standard practice" was referred to as "*the application of techniques, procedures, and data that are generally accessible to competent professionals in the field*" in the December 2012 version of the Eligibility Policy. This was adapted from the definition given in the *Northwest Hydraulic Consultants Ltd. v. The Queen* court case.

The way we had defined and used it in the policy, "standard practice" was essentially the application of the "scientific or technological knowledge base," which includes the knowledge from resources within the company and sources available publicly. We realized that there was no need for two such closely related terms. Since we had defined the "scientific or technological knowledge base" more clearly, we decided to remove the term "standard practice" in the April 2015 version of the policy.

This decision was supported by the fact that the term "standard practice" was confusing because it means different things to different people. "Standard practice" is not used by everyone with the same understanding that we had for it in the policy.

With respect to the specific issue raised here, the current Eligibility Policy states:

> ***"Development work is based on the application of the existing scientific or technological knowledge base, such as directly adapting a known engineering or technological practice to a new situation, where there is reasonable certainty of meeting the technological objectives. Under these circumstances, there is no technological uncertainty."***

Comparing the concept expressed in the current Eligibility Policy and the information in IC 86-4R3, we believe that the concept from the IC has already been captured in the Eligibility Policy. Therefore, we do not think that there is a need to provide further clarification.

d. Advancing Underlying Technology

In order to distinguish between: (a) work that is done to advance the underlying technology of a sub-system that results in technological advancement and (b) work that does not require the underlying technology to be advanced but allows for the system improvements that advances new technology, can the CRA confirm that the policies that had derived from IC 86-4R3 sections 2.10.1 and 2.10.2 are still valid?

Those sections had read as follows:

* * *

> 2.10.1 The criterion of scientific or technological advancement is as follows:
>
> - The search carried out in the scientific research and experimental development activity must generate information that advances our understanding of scientific relations or technologies. In a business context, this means that when a new or improved product or process is created, it must embody a scientific or technological advancement in order to be eligible.
>
> 2.10.2 The criterion of scientific or technological uncertainty is as follows:
>
> - Whether or not a given result or objective can be achieved, and/or how to achieve it, is not known or determined on the basis of generally available scientific or technological knowledge or experience. This criterion implies that we cannot know the outcome of a project, or the route by which it will be carried out without removing the technological or scientific uncertainty through a program of scientific research or experimental development. Specifically, scientific or technological uncertainty may occur in either of two ways:
>
> —it may be uncertain whether the goals can be achieved at all; or
>
> —the taxpayer may be fairly confident that the goals can be achieved, but may be uncertain which of several alternatives (i.e., paths, routes, approaches, equipment configurations, system architectures, circuit techniques, etc.) will either work at all, or be feasible to meet the desired specifications or cost targets, or both of these.

- The scientific or technological uncertainty, rather than the economic or financial risk, is important in characterizing scientific research and experimental development—and, hence, eligible activities.

- Sometimes there is little doubt that a product or process can be produced to meet technological objectives when cost targets are no object. In commercial reality, however, a reasonable cost target is always an objective, and attempting to achieve a particular cost target can at times create a technological challenge which needs to be resolved. A technological uncertainty may thus arise that is imposed by economic considerations. Otherwise, the more general question of the commercial viability of the product or process is not relevant to whether or not a technological uncertainty is present and, hence, to whether a project is eligible or ineligible.

- This criterion applies equally to work on new or existing processes or products. The description of technological uncertainty contained in this subsection applies wherever the text of this circular refers to the criterion.

* * *

CRA Response – 8d:

The Eligibility Policy states:

> *"Sometimes there is little doubt that a product or process can be developed when cost targets are no barrier. In commercial reality, however, a reasonable cost target is always an objective. Although such cost targets on their own do not create scientific or technological uncertainty, trying to meet them might. For example, cost targets may require that technologically uncertain paths be attempted, although more costly and proven alternatives exist. A technological uncertainty may thus arise that is imposed by economic considerations. Hence the existence of a costly technologically certain alternative does not negate the possibility that SR&ED work was performed to develop a product or a process."*

As already explained in the response to question a., the essential concept expressed in paragraphs 2.10.1 and 2.10.2 of IC 86-4R3 has already been captured in the current Eligibility Policy. Similarly, the concept of attempts to meet cost constraints leading to technological uncertainties is also already covered in the Eligibility Policy. Therefore, we do not think that there is a need to provide further clarification to describe the advancement in the underlying technology.

e. Follow-up with the CRA

If a dispute arises between a claimant and the CRA about policies or interpretations concerning the criterion of scientific or technological advancement, or the criterion of scientific or technological uncertainty, and the facts of the case are generally not in dispute, can the claimant seek clarification from CRA headquarters on these policies or interpretations?

CRA Response – 8e:

The SR&ED Program has a dispute resolution policy titled "Guidelines for resolving claimants' SR&ED concerns." This policy clarifies the roles and responsibilities of the claimants and the CRA, and it explains the three steps for resolving concerns. The first step is to talk to the Research and Technology Advisor (RTA) or Financial Reviewer (FR). The second step is to talk to the managers of the RTA or FR. And the third step is to request an administrative second review.

The administrative second review is under the responsibility of the SR&ED Assistant Director in the Tax Services Office (TSO), and not SR&ED HQ. However, when the issues pertain to fundamental differences in the interpretation of policies, HQ encourages the Assistant Director to seek clarification from the National Technology Sector Specialist team in HQ.

In addition to this dispute resolution process, all RTAs and FRs have the option of seeking clarification on specific technical issues from HQ. This resource is available to the review team at any point during the review.

Claimants cannot directly request clarification from HQ; the request must come through the reviewers, their managers, or the Assistant Director.