Statement

of

TAX EXECUTIVES INSTITUTE, INC.

on

PRE-BUDGET CONSULTATIONS

submitted to

HOUSE OF COMMONS
STANDING COMMITTEE ON FINANCE

August 6, 2014

Tax Executives Institute (TEI) is pleased to participate in this year's pre-budget consultations and offers the following recommendations to ensure fiscal sustainability, promote economic growth, and maintain a favourable investment climate. Our recommendations will improve Canada's taxation regime, streamline tax administration, and enhance the competitiveness of Canada's tax system.

Background

Tax Executives Institute is the preeminent worldwide association of in-house business tax professionals. TEI's 7,000 members work for 3,000 of the largest companies in Canada, the United States, Europe, and Asia, with representatives from all major industries and sectors of the economy. Canadians make up approximately 15 percent of TEI's membership and belong to chapters in Montreal, Toronto, Calgary, and Vancouver. In addition, many non-Canadian members work for companies with substantial Canadian operations, investments, and employees.

Executive Summary

TEI urges the Standing Committee to:

- Maintain the reduced corporate income tax rates implemented over the last decade, encourage the provinces to reduce their rates and continue harmonizing their tax bases with the federal base, and adopt measures increasing electronic filing of tax return information.

- Finish unfinished business from the Advisory Panel on Canada's System of International Taxation by —

    - Adopting a self-certification system under Canada's treaties for withholding tax exemptions on cross-border services; and

- Eliminating withholding taxes on corporate group dividends.

- Recognize that Canada has implemented measures curbing base erosion and profit shifting (BEPS) and thus "Go Slow" adopting recommendations from the Organisation for Economic Co-operation and Development's (OECD's) BEPS initiative.

- Improve the efficiency of tax dispute resolutions by according Canada Revenue Agency (CRA) authority to settle issues based on "risks of litigation."

Maintain and Enhance the Competitiveness of Canada's Tax Structure

The Government's commitment to decreasing the corporate income tax rate and broadening the tax base over the past decade has made the Canadian tax system globally competitive. TEI commends the Government for pursuing these objectives, thereby increasing Canada's attractiveness to investors. These measures helped Canada weather the global recession better and recover faster than many countries. But Canada must remain vigilant about maintaining its competitive advantage because other countries (*e.g.*, the United Kingdom) are reforming their tax systems.

As important, the Government has encouraged the provinces to adopt harmonized tax policies promoting Canada's competitiveness and improving the administrative efficiency of the provincial systems. Harmonized tax systems produce substantial administrative savings for the federal and provincial governments and permit the provinces to eliminate legacy administrative and compliance systems. We recommend that the Government continue encouraging the provincial governments to harmonize with the federal tax base and make rate reductions to maintain and enhance the competitiveness of Canada's tax environment.

Finally, the Government should continue to reduce red tape and paperwork, increase electronic filing of tax forms (*e.g.*, including Form T-106), and ensure CRA is well-funded and streamlines its audit and appeal procedures to maximize efficient tax administration.

Finish Unfinished Business

While TEI supports the strategic direction and pace of implementation of Canada's tax policies, there is unfinished business.

In November 2007, the Government created an Advisory Panel on Canada's System of International Taxation ("Advisory Panel") to recommend measures improving the competitiveness, efficiency, and fairness of Canada's international tax system. The Advisory Panel's report[1] endorsed:

A. *A self-certification system for obtaining treaty benefits under Regulations 105 and 102.*

[1] *Enhancing Canada's International Tax Advantage*, Advisory Panel on Canada's System of International Taxation (December 2008).

Sections 105 and 102 of the Income Tax Regulations impose withholding on payments for services rendered in Canada by non-residents. Under regulation 105, payments for contract services rendered in Canada are subject to 15-percent withholding tax. Under regulation 102, non-resident employers have withholding obligations similar to those of Canadian residents in respect of remuneration paid to employees who render services in Canada on behalf of non-resident employers. Absent an advance waiver from CRA, both withholding obligations apply even where the non-resident is exempt under a treaty.

To improve access to skilled services, the Advisory Panel recommended abandoning the current system and replacing it with a self-certification system (similar to the United States) where non-resident service providers certify entitlement to treaty exemptions.[2] We concur and urge (1) retention of the current information reporting requirements for non-resident employees and service providers and (2) repeal of the withholding tax under regulations 102 and 105, especially in respect of payments to U.S. employees and service providers.

B. *Reducing withholding tax rates on corporate group dividends.*

The Advisory Panel noted that reducing withholding taxes, especially on dividends, would benefit Canada economically.[3] TEI concurs and notes that *all* withholding taxes constitute unnecessary friction on cross-border transactions, especially where economies are highly dependent on the cross-border flow of goods, services, technology, and know-how.

The United States is a key market for Canadian goods, services, and investments by Canadians, and a key source of investment capital. Since 2003, the United States has negotiated a nil withholding rate for group dividends under many of its tax treaties. TEI believes steps should be taken to ensure that Canadian residents secure benefits similar to those enjoyed by residents of other U.S. treaty partners and effectively compete with those jurisdictions for increased investments, exports, and jobs. Hence, we urge the Standing Committee to recommend that the Department of Finance negotiate a protocol to the Canada-U.S. tax treaty eliminating withholding taxes on dividends to related group companies.

"Go Slow" Adopting BEPS Recommendations

The OECD has launched a project to address the perception that countries are losing corporate tax revenue because multinational enterprises (MNEs) have engaged in "base erosion and profit shifting" (BEPS) strategies. In parallel, the Government initiated a consultation in its 2014 Budget to "set its priorities and inform Canada's participation" in that project. TEI was pleased to participate in the consultation.

We have many concerns about the BEPS project.

First, through the last several budgets, the Government has undertaken targeted actions curbing base erosion, effectively carving out a "Made in Canada" BEPS Action Plan. Those actions include adopting limitations on interest deductibility (through the introduction of foreign

[2] *See* Recommendation 7.3 of the Report.

[3] Paragraph 6.8 of the Report.

affiliate dumping rules and enhancements to the thin capitalization regime) and curbing hybrid mismatches through the introduction of foreign tax credit generator rules. Canada also countered aggressive tax planning through enhanced disclosure rules and curbed potential base erosion through loss trading, character conversions, offshore insurance, and synthetic disposition transactions. In addition, amendments to the controlled foreign affiliate rules and the evolving anti-Treaty-shopping proposals will have far-reaching effects. As a result, Canada is at the forefront of curbing perceived base erosion and profit shifting.

Second, Canadian taxpayers are already required to provide a substantial amount of information about their foreign operations to CRA, which permits CRA to conduct transfer-pricing risk assessments. In addition, Canadian taxpayers must maintain contemporaneous documentation to support their transfer prices and produce such documentation upon demand. Many countries participating in the BEPS project do not have such rules. We do not believe CRA requires additional information for either risk assessment or substantiation of taxpayer transfer pricing.

Third, an underlying premise of the BEPS Action Plan is that MNE tax planning is offensive because it results in tax base erosion that must be curtailed. Government data from recent fiscal years suggests, however, that is not the case in Canada. According to Department of Finance statistics, corporate income tax revenues have remained stable through the past five fiscal years, both in absolute dollars and in proportion of total government revenues.

Finally, the countries participating in the BEPS project have widely varying economic conditions, budget priorities, and tax policies. Consequently, it is unlikely the OECD's recommendations will produce a single, consistent policy framework and questionable whether proposed rules will be consistently adopted or applied. Thus, the current patchwork of international tax rules will be even more confusing to comply with and the risks of multiple taxation exacerbated.

To avoid undermining Canada's tax system, TEI recommends that BEPS recommendations be implemented only after careful consideration of the *impact on the Canadian economy and particular industries* and only where consensus is reached by substantially all OECD members. Canada has already made significant strides curbing base erosion and should "Go Slow" adopting provisions that might undermine the tax system's competitiveness.

Accord Authority to CRA for "Risks of Litigation" Settlements

TEI recommends that legislation be adopted to improve CRA's administration of audits and tax appeals. Specifically, CRA should be accorded authority to settle controversies based on the "risks of litigation."

Under current law, the Minister of National Revenue "has a statutory duty to assess the amount of tax payable on the facts as he finds them in accordance with the law as he understands it. It follows that he cannot assess for some amount designed to implement a compromise settlement."[4] Thus, CRA is prohibited from settling matters where it believes that its legal

[4] *Frank H. Galway v. Minister of National Revenue* (1974), 74 D.T.C. 6355 at 6357 (F.C.A.).

position is correct — even where CRA and the Department of Justice recognize the prospects for success are uncertain, especially in terms of the amount of the assessment.

This shortcoming in tax administration was recognized in the 1997 Report of the Technical Committee on Business Taxation, which was commissioned by the Minister of Finance to make improvements in Canada's system of business taxation. "The present system . . . does not adequately recognize the inherent uncertainties of statutory interpretation. Given the costs, delays and uncertainties involved in resolving issues at trial, it can be of benefit to all parties to achieve compromise settlements in such situations."[5] Hence, the Technical Committee recommended that —

> . . . settlement of disputes regarding taxpayers' liability for tax be further encouraged by introducing a legislative mechanism that would authorize Revenue Canada, in appropriate circumstances, to enter into compromise arrangements on the basis of "risks of litigation." The terms of any such compromise should be approved by senior officials.[6]

TEI agrees and believes the administration of CRA's Appeals process has not improved since the Technical Committee's report was issued. Taxpayers are frustrated because they are unable to resolve disputes about uncertain issues without resorting to litigation. Moreover, when taxes are reassessed, the Notice of Objection rules require large corporations to pay fifty percent of the amount in dispute, which is a serious impediment to investment when the reassessments are unsustainable and take years to resolve.[7] Under a "risks (or hazards) of litigation" approach, the objective is to reach a fair and impartial resolution, one that "reflects on an issue-by-issue basis the probable result in event of litigation, or one which reflects mutual concessions for the purpose of settlement based on relative strength of the opposing positions where there is substantial uncertainty of the result in the event of litigation."[8]

TEI's recommended approach is similar to that employed in the United States and the United Kingdom.[9] Litigation is expensive and time-consuming and not every dispute between taxpayers and CRA must be resolved by the courts, even where both parties' positions are sound. With the enactment of enabling legislation, administrative guidelines, systemic checks, and appropriate reviews can be developed to ensure that cases that should be settled are settled, while issues that present important legal questions or require factual determinations are resolved by the courts. TEI would be pleased to assist in developing such guidelines.

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[5] *See Report of the Technical Committee on Business Taxation* (1997) at page 10.8.

[6] *Id.*

[7] An alternative approach to ensure balanced reassessments is to modify or eliminate the requirement to pay fifty percent of disputed tax amounts while retaining the obligation to state objections concisely.

[8] United States Internal Revenue Manual, section 8.6.4.1 (July 2014), at http://www.irs.gov/irm/part8/irm_08-006-004.html.

[9] *See Code of governance for resolving tax disputes*, HMRC Revenue and Customs (July 2014), at http://www.hmrc.gov.uk/adr/resolve-dispute.pdf.

Conclusion

TEI appreciates the opportunity to participate in the Committee's consultation and would be pleased to respond to questions. Please contact either Paul Magrath, TEI's Vice President for Canadian Affairs at 905.804-4930 (or paul.magrath@astrazeneca.com) or Grant Lee, Chair of TEI's Canadian Income Tax Committee, at 604.904.8454 (or grant_lee@hsbc.ca).

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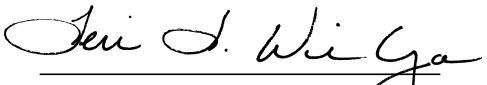
By: 

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