Recent Developments in Canadian Corporate Income Tax

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Presented by Ryan/FEI Canada

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RYAN/FEI CANADA – RECENT DEVELOPMENTS IN CORPORATE INCOME TAX

I. CRA Policy & Procedures Update
II. Canadian Compliance and Reporting Requirements
III. International Tax Considerations
IV. Case Law Update

SECTION I

CRA POLICY & PROCEDURES UPDATE

VOLUNTARY DISCLOSURES

WHAT IS A VOLUNTARY DISCLOSURE?

- The VD Program promotes tax compliance by ***encouraging*** taxpayers to ***voluntarily*** contact tax authorities and correct prior omissions or errors
- Where a ***valid*** disclosure is made one must pay the taxes or charges plus interest without penalty or prosecution:
  1. **IC00-1R4**- outlines CRA's administrative guidelines on the VDP and what constitutes a 'valid' disclosure
  2. **ADM.4/R2**- outlines Quebec's VDP policy and the conditions that must be met to benefit from the program
  3. **CT-11R2**- outlines Alberta's VDP policy and the required conditions
- Taxpayers are expected to be compliant after using the VDP and generally can only use the VDP once (unless circumstances beyond taxpayer's control)

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WHEN WOULD YOU CONSIDER IT?

- To correct inaccurate information
- To disclose information not previously reported
- Examples for VDP:

1. Failed to fulfill obligations under the applicable act
2. Failed to report taxable income
3. Claimed ineligible expenses on a tax return
4. Failed to remit employee source deductions
5. Failed to report GST/HST (including undisclosed liabilities, improperly claimed credits/refunds/rebates, unpaid tax)
6. Failed to file information returns
7. Failed to report foreign source income that is taxable in Canada

HOW DO YOU MAKE A VOLUNTARY DISCLOSURE?

- Submission is made in writing and mailed or faxed to appropriate tax centre
- Both CRA and Quebec provide for a “Named” and “No-Name” submission. Alberta only allows a “Named” submission
- Generally, a “No-Name” submission is made when you are unsure about your situation:
    1. Allows informal discussions with a VDP officer before your identity is revealed
    2. Discussions are not binding and general in nature
    3. Provides a better understanding of the risks involved in remaining non-compliant and the relief available under the VDP

PROCESS OF MOVING FROM “NO-NAME” TO “NAMED”

1. <u>Initial Letter from CRA :</u>
   a. acknowledges receipt of “No-Named” submission
   b. assigns a VDP reference number
   c. indicates that once an officer is assigned, have **90 days** to provide taxpayer’s identity
2. <u>Letter from CRA officer assigned to the file:</u>
   a. states the “effective date of disclosure” (“EDD”)
   b. lists outstanding information required to complete the VD
   c. states identity of taxpayer must be disclosed within 90 days of the EDD
   d. states that CRA will not make a final decision on the “No-Name” submission until identity is known and all facts verified

HOW DO YOU MAKE A VOLUNTARY DISCLOSURE? ADDITIONAL QUEBEC REQUIREMENTS

- Taxpayer or its representative initiates a VD by contacting the appropriate Quebec tax centre
- The information that must be submitted on the date of this first contact is:
  1. Disclosing the principal facts of the voluntary disclosure request
  2. Describing the transactions
  3. Stating the periods covered by the voluntary disclosure
  4. Indicating the Quebec fiscal laws concerned
  5. Providing the amount of taxes/duties payable for each period covered by the disclosure
- After analysing the data, Quebec will advise if the situation qualifies as a VD (subject to verification) and the documents that must be filed to finalize the disclosure

WHAT TAXES ARE COVERED BY THE CRA's VDP?

- VDP applies to disclosures for:

  1. income tax, source deductions
  2. excise tax, excise duties
  3. GST/HST
  4. charges under the *Air Travellers Security Charge Act and the Softwood Lumber Products Export Charge Act*

- The CRA does not have to grant relief under the VDP

- Each request is reviewed and decided on its own merits

WHAT DOES QUEBEC'S VDP APPLY TO?

- Applies to Quebec income tax and sales tax
- Quebec applies CRA's policy for the application of the GST under the *Excise Tax Act*
- Quebec's VDP applies to any situation where a penalty can be imposed and primarily applies to:
    1. Cases of fraud, false statements or omissions made in circumstances equivalent to gross negligence
    2. Certain cases of failure to file
    3. Situations involving a late-filing penalty or a penalty related to instalment payments

VDP LIMITATIONS- THE CRA

The CRA’s ability to grant relief is limited to submissions made on or after the following dates:

1. Income tax (**Jan. 1/95)** relief is limited to any tax year (or fiscal period for partnership) that ended within the **prior 10 years** before the calendar year in which the submission was filed.
2. For GST/HST, excise tax, and *Software Lumber Products Export Charge Act (*(**Apr. 1/07)** and is limited to reporting periods that ended within the prior 10-year period.
3. Excise duties under the *Excise Act, 2001 (*(**Apr. 1/07)** and is limited to fiscal months that ended within the prior 10-year period
4. *Air Travellers Security Charge Act*- on or before the day that is 10 calendar years after the end of the fiscal month

EXCLUSIONS FROM VDP- THE CRA

The following would not be eligible for the VDP:

1. Income tax returns *with no taxes owing or with expected refunds*
2. Elections - these are governed by the various acts administered by the CRA
3. Advance Pricing Arrangements
4. Rollover Provisions
5. Bankruptcy Returns
6. Post-assessment requests for penalty and interest relief

VALID DISCLOSURE- CRA

If the CRA accepts that the disclosure meets all the following 4 conditions, it will be considered a valid disclosure - no penalties, no prosecution

1. ***Voluntary*** - taxpayer not aware of an audit, investigation, enforcement action

2. ***Complete*** - taxpayer must provide full and accurate facts and documentation for all tax years in question

3. ***Penalty*** - disclosure must involve application of a potential penalty

4. ***One Year Past Due*** - the disclosure must include information at least one year past due, but may include current year only if other years meet this test

VALID DISCLOSURE- QUEBEC

If Quebec accepts that the disclosure meets all the following conditions, it will be considered a valid disclosure with no penalties& prosecution

1. ***Voluntary* - ** No demonstrable fact that Quebec was about to do a review, audit or investigation on the date of first contact
2. ***Complete -*** Disclose all relevant and important facts, information and documents to allow taxes/duties to be determined as accurately as possible
3. ***Verifiable -*** Make available all information, registers and documents to determine accuracy of taxes/duties and interest payable
4. ***Fiscal Debt Must be Paid -*** Must pay the taxes owing within the time prescribed by the law pursuant to the Notice of Assessment issued by Quebec on the voluntary disclosure

VALID DISCLOSURE- ALBERTA

If Alberta accepts that the disclosure meets all the following conditions, it will be considered a valid disclosure with no penalties & prosecution:

*1**. Initiated by Taxpayer*** - must be made before any compliance or audit action by Alberta, CRA or any other affected jurisdiction(s)

2. ***Complete -*** must provide complete and accurate facts and documentation

3. ***Subject to Verification*** - must make all books, records and documentation available and be fully co-operative with Alberta staff

3. ***Penalty*** - disclosure must involve the application of a penalty

4. ***One Year Past Due*** – generally the disclosure must include information at least one year past due

5. ***Full Payment -*** must pay taxes plus estimated interest (or make acceptable arrangements for payment) on submission of the disclosure

ACCESS TO TAXPAYER INFORMATION

WHY THE CRA IS REVISITING ITS POLICY ON ACCESSING INFORMATION?

1. To protect the confidentiality of taxpayer’s information
2. To formalize the process of obtaining various levels of consent
3. To specify the authority granted under each level of consent
4. To clarify when consent is given

CONSENT BEFORE AND AFTER AUGUST 2014

I. Pre-August 2014

Before August 2014, any of the following persons could access a company’s information to some degree.

- Owner / Director
- Contact Person
- Authorized Representative

II. Since August 2014

Now, only the following persons can obtain consent:

- Owner / Director
- Authorized Representative
  1) RC 59
  2) RC321

AUTHORIZED REPRESENTATIVES – RC59

- Full access to all information or access can be restricted to specific company accounts

- Access to information is continuous until the authorization is revoked, cancelled or expired

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AUTHORIZED REPRESENTATIVES RC59

<u>AUTHORIZATIONS:</u>

Online vs. Written

1. Online through *My Business Account* gives immediate access,
2. Written authorization - Form RC59 Business Consent via mail or fax.

<u>TWO LEVELS:</u>

- *Level 1* – allows the CRA to disclose information only
- *Level 2* – allows the CRA to disclose information and accept changes to taxpayer’s accounts

DELEGATED AUTHORITY (DA) RC321 (NEW)

Provides Level 3 authority for a taxpayer’s account:

1. The ability to add or cancel a representative or another DA
2. Direction to the CRA on tax matters of the business
3. Direction to the CRA on changes pertaining to identification or information.
4. The ability to make changes to taxpayer’s name, address, banking information, etc.
5. Signing authority of Form RC59 Business Consent, and other forms / documents requiring a signature

Level 3 authority also includes all Levels 1 and 2 capabilities

DELEGATED AUTHORITY (DA) - RC321

Executing a Form RC 321 – Canadian Residents – 3 Requirements

1. Must have a Rep ID
   - Need a SIN number to obtain a Rep ID – available only to residents
   - Register for Rep ID on-line through My Business Account

2. Must select program accounts to be covered by the DA
   - All company program accounts
   - Specific company program accounts

3. Must advise on the expiry date
   - can specify an expiry date
   - leave blank for continuous information access

DELEGATED AUTHORITY (DA) - RC321 continued

Executing a Form RC 321 – Non-Residents (NR) :

1. Only available to U.S. residents, other non-residents must file an RC59

2. Must have a Non-Resident Representative Number (NRRN)

3. NRRN is obtained by U.S. resident by filing Form RC391

Access To Taxpayer Information - Summary

1. “Contact Person” is no longer authorized

2. Authorized Representative or Owner / Director, three potential levels of authority available:

   - RC59 : Level 1 – access to information only

   - RC59: Level 2 – access to information and the ability to make changes to accounts.

   - RC321: DA – Level 3 – more information access, ability to designate /cancel other representatives (must have a REP ID)

GAAR UPDATE

GAAR Overview

1. Section 245 of the *Income Tax Act* (introduced in 1988)
2. Information Circular IC 88-2

“An avoidance transaction is a single transaction or one that is a part of a series of transactions where the single transaction or the series results directly or indirectly in a tax benefit, unless the transaction is carried out primarily for bona fide purposes other than to obtain the tax benefit”

“A transaction will not be an avoidance transaction if the taxpayer establishes that it is undertaken primarily for a bona fide business or investment purpose”

GAAR was designed to draw a line between tax minimization (which is legitimate) and abusive tax avoidance

GAAR

Canada Trustco [2 S.C.R. 601, 2005]

Supreme Court accepted the principle from *Commissioners of Inland Revenue v. Duke of Westminster* that taxpayers are entitled to arrange their affairs so as to minimize the amount of tax payable. It stated that the ITA must be interpreted in order “to achieve consistency, predictability and fairness so that taxpayers may arrange their affairs intelligently.”

The Court recognized that the ITA generally is interpreted in a textual manner, given the explicit provisions that dictate specific consequences. However, the GAAR is a “different sort of provision” enacted by Parliament to negate arrangements that are permissible under a literal interpretation of the ITA, if they are “abusive tax avoidance…”

Onus in on the taxpayer to refute the Minister’s assessment

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GAAR

Canada Trustco [2 S.C.R. 601, 2005]

1. Tax benefit
2. Transaction is an avoidance transaction in the sense that it cannot be said to have been reasonably undertaken or arranged primarily for a bona-fide purpose other than to obtain a tax benefit; and
3. There was abusive tax avoidance in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit, or purpose of the provisions relied on by the taxpayer.

GAAR Examples

Copthorne Holdings Ltd. v. Canada, 2011 SCC 63, [2011]

Two Canadian corporations within the same corporate group that had been parent and subsidiary became “sister” corporations .The sister corporations were then amalgamated, the paid-up capital (“PUC”) of their respective shares was aggregated to form the PUC of the shares of the amalgamated corporation. Had they remained as parent and subsidiary, the PUC of the shares of the subsidiary would have been cancelled on amalgamation. The amalgamated corporation then redeemed a large portion of its shares and paid out the aggregated PUC attributable to the redeemed shares to its non-resident shareholder. The payment was a return of capital with no withholding tax.

GAAR Applied

- Corporations owned by Li Ka-Shing
- Chinese state administration of taxation released SAT Order No. 32 on implementation of GAAR, effective February 1, 2015

GAAR Examples

Loss Consolidation

A corporation transfers property used in its business to a related corporation to permit the deduction of non-capital losses of the related corporation. All of the shares of the two corporations have been owned by the same taxpayer during the period in which the losses were incurred.

Valid tax deferral elections are permitted and GAAR would not apply unless the steps were taken to specifically avoid application of other restrictions under the Act (e.g., acquisition of control stop loss)

GAAR Examples

Loss Consolidation

A taxable Canadian corporation, which is profitable, has a wholly-owned taxable Canadian subsidiary that is sustaining losses and needs additional capital to carry on its business. The subsidiary could borrow the monies from its bank but the subsidiary could not obtain any tax saving in the current year by deducting the interest expense. Therefore, the parent corporation borrows the money from its bank and subscribes for additional common shares of the subsidiary and reduces its net income by deducting the interest expense. The subsidiary uses the money to gain or produce income from its business.

The borrowing by the parent corporation is for the purpose of gaining or producing income as required by paragraph 20(1)(c) and GAAR would not apply.

ROUNDTABLE UPDATE

CRA Roundtable Update – Latest Topics

- Loss consolidation arrangements – update
  - Dividend spread and independent source of income
  - Affiliated and related corporations
  - General considerations & GAAR
- Streaming partnership income

Loss Consolidation

Dividend spread and independent source income

- Loss arrangement – a taxable CANCO (“Profitco”) is related or affiliated to a taxable CDN corporation that has incurred NCL (“Lossco”). Under the loss consolidation arrangement, Lossco lends money to Profitco at a reasonable stated rate of interest and Profitco in turn uses the inter-corporate debt to acquire preferred shares of Lossco.

- For loss consolidation arrangements, it is the CRA’s policy not to provide rulings without a positive spread between the interest paid and the dividends earned

Loss Consolidation

Dividend spread and independent source income

- CRA expressed their view in Income Tax Technical News No. 30 (May 21, 2004) – “The key criteria to be met in such situations is the existence of other assets in the parent company that can generate sufficient income to pay the dividends on the preferred shares held by the subsidiary

- Whether the funding for the dividend payments is acceptable will depend on the circumstances and the particular loss consolidation structure

- CRA encourages taxpayers with a concern to request an advance income tax ruling

Loss Consolidation

Affiliated and related corporations under loss consolidation arrangements

- Prior to 1996 – loss consolidation arrangements only where corporations were related.
- After 1995, concept of “affiliated person” introduced in ITA (section 251.1) which could be used under certain loss restriction provisions. As a result, loss consolidations were changed to allow loss transactions only where the corporations were affiliated.
- During 2010 – CRA issued a ruling for a loss consolidation where two corporations were related, but were not affiliated.

Loss Consolidation

Affiliated and related corporations

- 2014 Roundtable – CRA was asked if it can confirmed its position as to whether corporations must be affiliated, related, or both affiliated and related in a loss consolidation arrangement.
- CRA has stated it will provide ruling requests where corporations are related and affiliated, as well as circumstances in which the corporations are related.
- Where corporations are not related, but are affiliated, CRA would consider a loss consolidation arrangement only if the corporations are affiliated by reason of *de jure* control.
- *De jure* control -- considered the legal ownership test where a person or group has greater than 50% ownership of the common shares with the ability to elect the majority of the board of directors.

Loss Consolidation

General Considerations & GAAR

- Federal Budgets 2010 and 2012 stated an intention to undertake a consultation process to consider implementing new rules for the taxation of corporate groups – this would allow for a formal system of loss transfers or consolidated reporting.
- Federal Budget 2013 announced it would not proceed with the implementation of a formal corporate group taxation system.
- During he 2014 Roundtable update, CRA noted that the 2013 Federal Budget announcement has not had an impact on the advance income tax rulings for loss consolidation arrangements.

Loss Consolidation

General Considerations & GAAR

- CRA's position continues to be that certain loss consolidation arrangements are in accordance with the scheme of the Act and do not usually result in a misuse or abuse for the purposes of GAAR. Some examples that are not a misuse or abuse of the Act are as follows:

  - Shareholder loan agreements
  - Rules for sale of tax losses

- Please note: where CRA considers that one of the main reasons for engaging in a loss consolidation arrangement is for the purpose of shifting income among provinces, it may challenge that loss consolidation under provincial GAAR legislation

Streaming Partnership Income - Example

- Partner A (Corporation with Losses) and B (corporation with no shelter) agree to amend partnership agreement so Partner A receives only interest income and Partner B receives only dividend income.

- Additional interest income that is allocated to Partner A is done so to offset Partner's A available tax losses. Dividends allocated to Partner B are not subject to tax and are deductible under subsection 112(1).

- Partnership agreement is amended to legally effectuate the partnership income streaming.

Streaming Partnership Income – CRA Views

- Issue – Can a partnership stream certain types of income to particular partners where partnership agreement is legally amended.

- CRA's view is that streaming of certain types of income to a particular partner is not acceptable and CRA would apply:
  - Subsection 103(1) – Sharing of income to postpone tax:
  - GAAR – Section 245

SECTION II

CANADIAN COMPLIANCE AND REPORTING REQUIREMENTS

REGULATION 105/102

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REGULATION 105

- Regulation 105 applies to payments made by a corporation to a non-resident individual or corporation for services rendered by the non-resident physically in Canada
- The tax must be withheld on all payments for services physically rendered in Canada, including the payment of fees, commissions or other amounts
- The corporate payer, as the withholding agent, must withhold 15% tax and remit to the CRA by the 15^{th} day of the month following payment.
- If the services are rendered in Quebec, an additional 9% must also be withheld and remitted to Revenu Quebec.
- The tax withheld is a payment of tax on account of the non-resident’s potential Canadian tax liability. The final tax is determined when the non-resident files its Canadian income tax return.

REGULATION 105 - TREATY EXEMPTION?

- If the non-resident service provider is exempt from Canadian taxation under a Tax Treaty (i.e., no permanent establishment exists), the non-resident can apply to the CRA for a Regulation 105 Withholding Tax Waiver.
- Upon receipt of a waiver certificate, the payer will not be required to withhold and remit tax under Regulation 105 prospectively
- If the CRA has not provided a waiver to the payer, and the payer fails to withhold and remit the tax, the payer will be liable for the Regulation 105 withholding tax

REGULATION 105 – Tax Exemption/Recovery

- If the non-resident service provider is exempt from Canadian taxation under a Treaty then the non-resident:

  1. Can apply for a Regulation 105 Waiver with the CRA **before** the services are rendered in Canada

  2. Can file a treaty based tax return with the CRA, in the following year, to recover the 15% tax withheld (the withholding tax is an installment and not a final tax)

- Only with receipt of a waiver certificate is the payer is not required to withhold tax under Regulation 105 on prospective payments

- Two types of waivers: (a)Treaty (b) Revenue & Expense

REGULATION 105 - Examples

Situations when Regulation 105 applies

- Canadian corporation hires U.S. third party provider for services to be performed physically in Canada
- Canadian subsidiary engages U.S. Parent for services (including management services) performed in Canada
- U.S. corporation engages a U.S. third party service provider for services to be physically performed in Canada
- U.S. corporation directly performs services in Canada for a Canadian customer

REGULATION 105 – Compliance & Penalties

T4A NR REPORTING

- The payer must file a T4A-NR return annually by February 28 of the following year
- The minimum penalty for late filing the T4A-NR information return is $100 and the maximum penalty is $7,500
- The penalty for failing to distribute T4A-NR slips to recipients is $25 per day for each such failure with a minimum penalty of $100 and a maximum of $2,500.

FAILURE TO DEDUCT AND/OR REMIT

Failure To Deduct - Penalty of 10% of the tax amount; 20% for second failure and/or gross negligence.

Failure/Late to Remit - 3% 1-3 days late; 5% 4-5 days late; 7% 6-7 days late; 10% > 7 days; 20% for second failure or gross negligence

Quebec – Separate 15% penalty

<u>CORPORATE COMPLIANCE</u>

- Annual Form T2 ($2,500 compliance penalty)

REGULATION 102

- Every corporation paying salaries, wages or other remuneration must withhold and remit Canadian payroll taxes unless a Regulation 102 Waiver is issued by the CRA
- If the corporation has an establishment in Quebec, it must also withhold and remit Quebec payroll taxes, unless a waiver is issued by Revenu Quebec
- Regulation 102 determines the amount of payroll taxes that must be withheld and remitted
- Payroll taxes must be remitted by the **15th** day of the month following payment of the remuneration to the employee

REGULATION 102- NON-RESIDENT EMPLOYERS

- Applies to non-resident employers who send their employees to work in Canada
- There is no 'de minimis rule' for the requirement to withhold- must withhold taxes for even 1 day
- Where the Regulation 102 Form R102-R waiver is provided to the employer, Canadian payroll withholding under Regulation 102 can cease prospectively
- If a non-resident employee is exempt from Canadian personal income tax and does not obtain a waiver, the employer will still be held liable for the Canadian payroll withholding taxes, **even if** the employee was technically exempt from Canadian personal income taxes under the tax treaty

REGULATION 102 WAIVERS

- If the non-resident employee is exempt from Canadian personal income tax under a tax treaty, he/she may apply for a Regulation 102 waiver
- The waiver should be applied for before the non-resident employee works in Canada (normally 30 days before)
- The waiver application is made on a calendar year basis. A separate waiver application must be made for each calendar year
- The application process consists of two main documents:
  1. Form R102-R Regulation 102 Waiver Application
  2. From T1261- Application for a CRA Individual Tax Number
- The application is signed and submitted by the employee

REGULATION 102 – Compliance & Penalties

T4 REPORTING

- Corporations must file an annual T4 Information Return due by February 28 even if Regulation 102 waivers have been issued
- The minimum penalty for late filing the T4 information return is $100 and the maximum penalty is $7,500
- The penalty for failing to distribute T4 slips to recipients is $25 per day for each such failure with a minimum penalty of $100 and a maximum of $2,500.

FAILURE TO DEDUCT AND/OR REMIT

Failure To Deduct - Penalty of 10% of the tax amount; 20% for second failure and/or gross negligence

Failure/Late to Remit - 3% 1-3 days late; 5% 4-5 days late; 7% 6-7 days late; 10% > 7 days; 20% for second failure or gross negligence

Quebec – Separate 15% penalty

T1135 REPORTING

Foreign Income Verification Statement

Who must file Form T1135?

- Any Canadian resident individuals, corporations or trusts that hold specified foreign property with a cost amount exceeding $100,000, at any time in the year

- Partnerships whose non-resident members' share of income or loss is less than 90% during the reporting period

What is Specified Foreign Property (SFP)?

- Foreign bank accounts
- Interest in foreign trusts/mutual funds
- Shares in foreign corporations (not foreign affiliates)
- Real estate owned outside of Canada
- Indebtedness from non-residents
- Life insurance policies issued by a foreign insurer
- Tangible and intangible properties located outside Canada

What SPF does not include?

- Foreign property held in a Canadian-based mutual fund
- Property used or held exclusively in the course of carrying on an active business
- Foreign property held for personal use and enjoyment, such as a vehicle, vacation property, artwork, etc.
- Interests in a non-resident trust that neither the taxpayer nor a relative had to pay for (e.g., an estate)

SFP and T1125

<u>What is not included on the T1135?</u>

- Canadian companies trading on a Foreign stock exchange
- Canadian shares held in U.S.$ brokerage account

<u>What is included on the T1135?</u>

- Foreign companies on the Canadian Stock Exchange
- TMX.com has a list of all U.S. companies that are listed on the TSX and TSXV

What must be reported?

- Name of foreign institution holding funds
- Name of specific investment
- Country to which the investment relates
- Income/loss and/or capital gain/loss realized for each property
- Highest cost amount of each property during the year
- Cost amount at year-end

Foreign Reporting – T1135 Additional Changes

- For 2014 and later years, accounts held with a Canadian registered securities dealer or Canadian trust company can be aggregated on a country by country basis
- Special “Category 7” created on Form T1135 for this reporting
- Maximum FMV can be based on month end FMV
- Same streamlining provisions apply to a unit trust
- If T3/T5 received from a Canadian issuer, the underlying investment historically was exempt from T1135 reporting. commencing in 2014, this exemption has been removed.

Timing for Filing T1135

- The due date is the filing date of the taxpayer tax return or information return

- For only the 2013 taxation year, the deadline was extended to July 31, 2014 due to the implementation of the new form.

- The form is not currently filed electronically with the tax return, but must be sent separately by mail to the Ottawa Technology Centre.

Failure To File - Penalties

- $25 per day to maximum of $2,500 (100 days)
- Gross negligence - $500 per month to maximum of $12,000 (24 months)
- After 24 months – 5% of greatest cost of foreign property

INTERNET BUSINESS ACTIVITIES

Reporting of Internet Business Activities

Background

- This new requirement was part of a project designed to “level the playing field” between traditional business and internet sales
- There is no specific legislation sanctioning the requirement to file Schedule 88
- Non-compliance could result in penalties for failure to file information returns, which could add up to as much as $2,500 per year

Reporting of Internet Business Activities

Who must file?

- Corporations who earn income from one or more web pages or websites that they administer

- Corporations that do not have a website but have created a profile or other pages describing its business on a website operated by others (i.e., a blog, auction, market place or any other portal or directory website) from which it earns income

- Partnerships currently are not required to report

Reporting of Internet Business Activities

What must be filed?

- A one-page schedule 88, "Internet Business Activities," with the T2 return if income earned from one or more web pages or websites

Filing requirement does not indicate if:

- It has to be directed to Canadian or foreign customers
- It must be carried on throughout the year e.g., Crowdfunding portal

Any taxpayer that is required to file a T2 and earns internet income anywhere in the world is required to file Schedule 88

Reporting of Internet Business Activities

Web pages and websites to report include:

- Goods/services sold via a web page
- Orders received via a form on a web page
- Advertising, income programs or traffic the site generates (e.g., income from Google AdSense, Microsoft adCenter or other affiliate programs)
- A web page like a blog, auction, market place or any other portal or directory website from which you earn income

Reporting of Internet Business Activities

Web pages and websites not to be reported include:

- Telephone directory websites that list your website or web page
- Information only websites or web pages, which give basic contact information for the business and general information about the type of goods and services provided by the business

Reporting of Internet Business Activities

Percentage of gross Internet income

- Report the gross income received from all of your Internet business activities as a percentage of your total gross income
- If the taxpayer cannot determine the exact percentage, then a reasonable estimate will suffice.

Provide the URL of up to five web sites through which the business generates income.

SECTION III

INTERNATIONAL TAX CONSIDERATIONS

THIN CAPITALIZATION

Thin Capitalization - Background

- Subsection 18(4) of the ITA restricts a deduction for interest paid or payable by a Corporation resident in Canada in a taxation year on debts owing to a specified non-resident

- The intent of these rules is to allow Canadian corporations to be financed by their non-resident shareholders using reasonable levels of debt while protecting the Canadian tax base against interest deductions from excessive amounts of debt

Thin Capitalization

- Debt / equity ratio reduced from 2 to 1 to 1.5 to 1 (tax years beginning after 2012)

- Calculating the interest amount on outstanding debts to a specified non-resident under 18(5) of the ITA is required when;

  1. Non-residents that, alone or together with non-arm's length persons, own shares with 25% of the votes or value of the corporation; or

  2. Non-residents that are non-arm's length with a shareholder that owns 25% of the votes or value of the corporation

- Non-deductible interest deemed paid as a dividend – results in withholding tax of 5% or 15% for U.S. resident lenders (from interest withholding of 0%, assuming treaty relief available)

- Debt of partnerships allocated to corporate partners for thin capitalization

Thin Capitalization – 2013 Budget

- Federal Budget 2013 – further thin capitalization changes
- Rules extended to Canadian resident trusts and non-resident corporations (branches) / trusts operating in Canada
- Effective for tax years beginning after 2013

Thin Capitalization – 2014 Budget

- Federal Budget 2014 – further thin capitalization proposed changes
- Extends rules to certain back-to-back arrangements
- Canadian company will be deemed to owe amounts to the non-resident person rather than the intermediary for thin cap purposes and withholding tax

PERTINENT LOANS & OTHER INDEBTEDNESS (PLOI)

Shareholder Loans – Non Residents

Without Pertinent Loan or Indebtedness (“PLOI”) Election

- Where the loan remains outstanding at the end taxation year in which the loan arose, subsection 15(2) of the ITA will deem the loan to be income of the non-resident party connected with the shareholder

- Where non-resident borrower does not maintain a permanent establishment in Canada (under Treaty), it is not subject to taxation on the income earned under Part I of the ITA.

- Subsection 214(3) of the ITA will deem the income inclusion to be a dividend

- Pursuant to section 212 of the ITA, a domestic withholding rate of 25% applies to the payment of a dividend (such rate may be mitigated by international tax treaty)

Shareholder Loans – Exemptions

Various exceptions exist:

- **15(2.2) – *Non-resident persons :*** subsection (2) does not apply to indebtedness between non-resident persons

- **15(2.3) – *Ordinary lending business:*** subsection (2) does not apply to debt that arose in the ordinary course of the lender's business of lending money where, at the time the indebtedness arose or the loan was made, bona fide arrangements were made for repayment of the debt or loan within a reasonable time.

- **15(2.6) – *Repayment within one year***: subsection (2) does not apply to a loan or indebtedness repaid within one year after the end of the taxation year of the lender where it is established that the repayment was not part of ***"a series of loans or other transactions and repayments"***

Pertinent Loan or Indebtedness (“PLOI”)

With New Exemption : 15(2.11) – *PLOI Election*

- Amount becomes owing after March 28, 2012
- No deemed dividend
- Corporation resident in Canada (“CRIC”) is controlled by a non-resident corporation that:
  - is the subject corporation; or
  - does not deal at arm’s length with the subject corporation
- In the case of an amount owing to the CRIC, the CRIC and a non-resident corporation that controls the CRIC jointly elect on or before the filing of the CRIC tax return for the relevant year (*on loan by loan basis*)
- The result of being a PLOI is that instead of a deemed dividend under 15(2) and 214(3), interest imputation applies under s.17.1

Pertinent Loan or Indebtedness ("PLOI")

- Imputed interest income at greater of:
  - interest computed at the "prescribed rate" ; and;
  - the amount of any interest payable on any debt of the CRIC
- The prescribed rate is the rate set by Regulation 4301(b.1)
- The prescribed rate is based on the Government of Canada Treasury Bills during the first month of the quarter preceding the particular quarter rate plus 4%
- The current prescribed rate for the 1st calendar quarter for 2015 is 4.89%

Pertinent Loan or Indebtedness (“PLOI”)

Other Considerations

- Election can be late-filed with penalty
- No prescribed form for the election
- Election is to be made on a loan by loan basis – could lead to practical issues under cash pooling arrangements
- Loan arising before March 29, 2012 can not be repaid and replaced with new loan elected under PLOI

HYBRID ENTITIES

Hybrid Entities

- A hybrid entity is an entity that is subject to different tax treatments between two international jurisdictions. Generally, the domestic jurisdiction considers the entity to be “fiscally transparent” and not subject to domestic tax while the foreign jurisdiction regards the entity as not fiscally transparent for foreign tax.

- The current year profits of a fiscally transparent entity are currently taxable to the owners of the entity, regardless of whether the entity made any distributions to its owners during that year.

- **Partnerships** are typically fiscally transparent entities.
  Corporations are typically not fiscally transparent entities.
  Limited liability companies may or may not be fiscally transparent.

- A reverse hybrid entity is the “reverse” of a hybrid entity in that the entity is fiscally transparent for foreign tax purposes but not fiscally transparent for U.S. tax purposes.

Hybrid Entities – Considerations

- CRA considers a US Limited Liability Company (LLC) as a corporation
- Foreign taxes paid by reverse hybrid partnerships are considered as taxes paid by the partners (important for foreign tax credit calculations)
- Are hybrid entities eligible for tax treaty benefits?
- Fifth Protocol to Canada/US Income Tax Treaty addresses tax treaty benefits to “fiscally transparent entities” – Residence Article IV Paragraphs 6 and 7. Impacts LLC, ULC, Partnerships
- Generally the provisions consider whether the tax treatment is the same in the absence of use the fiscally transparent entity. If yes, treaty benefits generally apply; If No, treaty benefits may be denied
- Without treaty benefits, distributions may be subject to gross domestic withholding (30% USA; 25% Canada)

Use of Hybrid Entities and Instruments - Financing

- **Tower Financing Structures** – Dual interest deduction utilizing domestic corporation lending to domestic hybrid in between a foreign operating sandwiched structure.

- **Hybrid Mismatch Financing Instrument** - One jurisdiction treats distribution on instrument as interest while another jurisdiction considers the distribution as a dividend.

- **REPO Structures** – Repurchase of securities transaction where the home country of operations considers payments as deductible interest and the foreign country characterizes the receipt as a non-taxable dividend.

- Such structures are complex, require application of tax treaties to reduce or eliminate withholding, and can require year to year maintenance to establish proper substance.

BEPS

BEPS – Base Erosion and Profit Shifting

- **WHAT** - Examines whether or not current tax regulations allow for the allocation of taxable profits to locations different from those where the actual business activity takes place.

- **WHY** – Declaration on BEPS at meeting of Organisation for Economic Co-operation and Development (OECD) counsel in Paris in May 2013.

- “governments lose substantial corporate tax revenue because of international tax planning that has the effect of artificially shifting profits to locations where they are subject to a more favourable tax treatment”

- **15 specific actions -** The plan addresses the borderless digital economy and develops a new set of standards to prevent double non-taxation. For quicker implementation, a multilateral instrument to amend bilateral tax treaties will be developed.

BEPS – Base Erosion and Profit Shifting

- Global initiative
  - Action Plan was fully endorsed by the G20 Finance Ministers and Central Bank Governors at their July 2013 meeting in Moscow
  - G20 Heads of State at their meeting in Saint-Petersburg in September 2013.

- Action plan to be introduced over 18 to 24 months.

- For the first time ever in tax matters, non-OECD/G20 countries are involved on an equal footing.

- International desire to preserve the tax base with focus on:
  - Hybrids
  - International Financing Structures
  - Tax Treaty LOB

BEPS – 15 Action Items

ACTION	YR		ACTION	YR	
1	2014	Digital Economy	9	2015	Transfer Pricing - Risks & Capital
2	2014	Hybrid Mismatch	10	2015	Transfer Pricing - Other High Risk Areas
3	2015	Strengthen CFC Rules	11	2015	Data Collection/Analysis on BEPS
4	2015	Base Erosion Limitation - Interest	12	2015	Domestic Disclosure
5	2014	Examine Member Country Tax Regime	13	2014	Transfer Pricing Documentation
6	2014	Design of Tax Treaties	14	2015	Effective Dispute Resolution
7	2015	Artificial Avoidance of PE	15	2014	Multilateral Instrument
8	2014	Transfer Pricing - Intangibles			

BEPS – OECD

- OECD pushing for change in domestic law to expedite change by denying tax deductions.
- Limitation of Benefit (LOB) articles in tax treaties
- Concept of "ultimate beneficial owner"
- "Main purpose test" (BEPS #6)
- Multi-lateral instrument to amend tax treaties – TBD
- the OECD is generally starting from the position that there should be definitive rules that remove the benefit of hybrids without considering whether a particular country .

Ryan

Canadian & U.S. Actions – Historical & Prospective

- Canada had introduced “anti-double dip” legislation through section 18.2 (2007 Federal Budget). Repealed by 2009 Budget.
- Canada introduced new thin capitalization rules limiting deduction to 1.5:1 and extending rules to partnerships/trusts/branches.

- U.S. has “dual consolidated loss” and “anti-conduit financing” regulations
- U.S. previously acted to deny benefits of FTC splitters

- US Treasury Green Book Fiscal 2015 Budget proposals:

1. 163(j) thin capitalization limitation to 40% of ATI vs. 50%
2. No carry-forward for excess 163(j) limitation after 2014
3. New regime for U.S. interest denial for inbound companies based on a world-wide leverage test
4. Denial of interest/royalty deduction through hybrid structures (e.g., repo structures)

SECTION IV
CASE LAW UPDATE

Les Abeilles Service de Conditionnement Inc

- On October 23, 2014, the Tax Court of Canada (TCC) released its decision in ***Les Abeilles Service de Conditionnement Inc***.

- The TCC overturned the CRA's position that certain projects under dispute were not SR&ED and that the activities:
    - Were not undertaken to resolve technological obstacles
    - Did not follow a systematic investigation
    - Were routine in nature

- TCC ruled in favor of the taxpayer, with the following findings:
    - SR&ED projects must be considered at the highest level
    - Project must be considered in totality
    - Maintaining contemporaneous documentation is useful but not required to substantiate SR&ED

- CRA may appeal

Les Abeilles Service de Conditionnement Inc

Important concepts from the court ruling:

- SR&ED qualification is in the nature of the activity and not necessarily the contemporaneous documentation
- Achieving an advancement is not an SR&ED requirement. The TCC referred to the attempt to improve in qualifying SR&ED
- Technological progress, however small, in the manufacturing process is “technological advancement”
- The need for the solution to be commercially viable / cost effective is a consideration in SR&ED eligibility
- Projects should be viewed as a whole, across multiple years, not de-constructed

THANK YOU!

Clyde Seymour, CPA CA, MACC
Principal, International Income Tax, Canada
Email: clyde.seymour@ryan.com

Jan Stapleton, CPA CA, MBA
Manager, Domestic & International Tax
Email: jan.stapleton@ryan.com

Chevonne Robinson
Manager, Domestic & International Tax
Email: chevonne.robinson@ryan.com

RYAN ULC
6775 Financial Drive
Mississauga, ON, L5N0A4
Office – (905) 567-7926
Fax - (905) 567-5549

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