

COMMENTS CONCERNING CANADA CUSTOMS AND REVENUE AGENCY INCOME TAX  
INFORMATION CIRCULAR NUMBER IC 71-17R5

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These comments were prepared by individual members of the Committee on Transfer Pricing of the Section of Taxation. Principal responsibility was exercised by Henry J. Birnkrant. Substantive contributions were made by Francois Vincent and David Canale. The Comments were reviewed by Robert E. Liles, II, of the Section's Committee on Government Submissions and by Elinore J. Richardson, Council Director for the Committee on Transfer Pricing.

Although many of the members of the Section of Taxation who participated in preparing these Comments have clients who would be affected by the Canadian federal tax principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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## COMMENTS CONCERNING CANADA CUSTOMS AND REVENUE AGENCY INCOME TAX INFORMATION CIRCULAR NUMBER IC 71-17R5

We appreciate the opportunity to comment on the draft Information Circular 71-71R5 (the “Draft IC”). Overall, we think the greater detail that the Draft IC provides on the competent authority (“CA”) process is a welcome improvement on the existing IC 71-17R4. Our specific comments and concerns with respect to the Draft IC are as follows:

### **Typical Requests for CA Assistance**

Paragraph 4 of the Draft IC states that CA assistance may be requested under the mutual agreement procedure (“MAP”) article of a Canadian tax convention if the actions of one or both of the parties to the tax convention will result in taxation not in accordance with the convention. In the list of examples of taxation not in accordance with a Canadian tax convention, the Draft IC includes the typical case of a taxpayer in a treaty country that is subject to additional tax as a result of an adjustment by the revenue authority of that treaty country to the price of goods or services transferred to or from a related party in Canada.

However, CA situations also commonly arise in instances where the Canada Customs and Revenue Agency (“CCRA”) makes an adjustment that causes a taxpayer to be subject to additional tax. We therefore suggest that Paragraph 4 of the Draft IC add this converse case. Specifically, we recommend that the examples in Paragraph 4 of the Draft IC include the situation where a taxpayer in Canada, who is subject to additional tax because of a CCRA-proposed adjustment to the price of goods or services transferred to or from a related party in a treaty country, requests that the Canadian CA secure a corresponding deduction for the related party in the treaty country to prevent economic double taxation.

### **Legal Resources Utilized by the CA**

Paragraph 9 of the Draft IC lists the legal resources that the CA will use in order to resolve a CA Request. We suggest that the Draft IC clarify that the tax authorities will, in appropriate circumstances, depart from purely domestic law, such as the Income Tax Act (“ITA”) and Canadian case law, in order to prevent taxation that is not in accordance with the provisions of an applicable Canadian treaty. The reason for the treaty is to produce consistent tax treatment. We therefore recommend that the language in the Draft IC make clear that the Canadian CA is to prevent taxation that is not in accordance with the applicable treaty even if doing so is contrary to purely domestic law.

### **Making a CA Request**

The Draft IC states that, with respect to an adjustment that affects related parties in Canada and a treaty country, the related party in the treaty country must make a request

for CA assistance in the country in which it is a resident.<sup>1</sup> We are concerned that this statement could be perceived as dictating what is required in the other tax jurisdiction. We propose instead that the Draft IC be revised to require each taxpayer to satisfy the requirements in his home jurisdiction in order to secure the competent authority assistance of the country in which the taxpayer is a resident.

### **Audit v. CA Process**

Paragraph 14 of the Draft IC states that the CA process will not commence until an audit is complete. As worded, the Draft IC could prevent a taxpayer from securing the benefit of CA assistance before double taxation actually occurs by curtailing the CA process until after the audit is concluded and double taxation occurs. This result appears to run counter to Paragraph 12, which allows a taxpayer to request CA assistance if the taxpayer believes that the actions of a taxation authority results, or *will result*, in double taxation. We recommend that Paragraph 14 be revised to permit a taxpayer to commence the CA process upon filing a request for CA assistance without regard to whether the audit is complete.

### **Appeals vs. CA**

We would like to commend you for allowing the Canadian CA to review assessments by the Appeals Branch of the CCRA.<sup>2</sup> We applaud providing a taxpayer with access to an objective review of the audit position without jeopardizing the taxpayer's rights to the CA process as a welcome and effective step in the resolution process.

However, Paragraph 30 of the Draft IC states that the Canadian CA will give substantial weight to the findings made by the Appeals Branch with regard to, *inter alia*, the provisions of any relevant treaty. We would expect that it is rather seldom, if at all, that the Appeals Branch makes findings with respect to the provisions of an applicable treaty. Thus, we would suggest that further consideration be given to the nature of the Appeals Branch's participation in this process. If the Appeals Branch confirms that it does not make such findings on the provisions of treaties, then we would recommend that the paragraph be revised to reflect this.

### **Complete Requests and Taxpayer Co-operation**

While we generally agree with the need for taxpayers to present CA requests that are complete and accurate,<sup>3</sup> we are concerned with the introduction of the notion of taxpayer co-operation as currently presented in the Draft IC. Paragraph 20 of the Draft IC contains the customary admonition that full co-operation by a taxpayer with the CA process is expected. The fact that the Canadian CA may request information that was not requested during an audit or that was requested but not provided during an audit, and that a

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<sup>1</sup> Paragraph 12 of the Draft IC.

<sup>2</sup> Paragraphs 29 and 30 of the Draft IC.

<sup>3</sup> Paragraphs 13, 16 and 17 of the Draft IC.

taxpayer's failure to provide such information may have direct consequences on whether the taxpayer will obtain relief, seems to fall outside the traditional role of the CA.

Our understanding is that the Canadian CA does not attempt to re-do the audit in the context of the CA process. We are concerned that, if an "auditor" frame of mind is incorporated into the CA process, the process would become more adversarial and could result in a less objective and less efficient resolution of the issues. On the other hand, we recognize that the CA may need additional information in order to properly deal with the issues. We suggest that the Draft IC balance these competing interests by confirming that the role of the Canadian CA is not to attempt to re-do the audit but it may request additional information that is deemed necessary for effective resolution of the matter.

We also suggest retaining Paragraph 16 of the Draft IC as an indication of what taxpayers should strive to include in a competent authority request. Clearly, the more complete the request, the more likely relief will be granted and the more expeditiously it will be handled.

### **Corresponding Adjustments**

Paragraph 21 of the Draft IC states that corresponding adjustments may only be made with the assistance of the Canadian CA.<sup>4</sup> We agree that taxpayers should not unilaterally adjust the price of goods or services charged or received by a related party to reflect adjustments made by the taxation authority of the related party's home country. We recommend, however, clarifying this provision by adding a sentence to distinguish corresponding adjustments from compensating adjustments, which are acceptable in certain situations and must occur prior to filing the tax return for the relevant taxation year.

### **Anti-avoidance and CA**

Paragraph 38 of the Draft IC provides that the Canadian CA will not negotiate cases where the primary position of a Canadian-initiated reassessment is based on the anti-tax avoidance sections of the ITA. We are concerned about situations where the Canadian tax authority may deem a transaction to have occurred (for instance, through a power of recharacterization under sections 247(2)(b) and (d) of the ITA) where no such transaction was intended by the parties nor, in fact, did it occur, but the foreign tax authority on the other side of the transaction does not view the deemed transaction as occurring. Although we recognize that taxpayers structure transactions to take advantage of different characterizations by different taxing authorities, in our view, the Draft IC could create situations that potentially result in irremediable double taxation.

We do not believe the outright refusal to entertain such cases by the Canadian CA<sup>5</sup> is necessary to protect the CA process. The position set forth in the Draft IC could be made more flexible by providing that the Canadian CA will negotiate cases where either the

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<sup>4</sup> Paragraph 21 of the Draft IC.

<sup>5</sup> Paragraph 38 of the Draft IC.

Appeals Branch or the Tax Court of Canada rule that the anti-avoidance provisions of the ITA are not applicable. Of course, if the taxpayer is required to go to the Tax Court of Canada to confirm that anti-avoidance provisions of the ITA are not applicable, the Canadian CA should not be able to simply rely on Paragraph 32 of the Draft IC to decline to negotiate the case. At a minimum, further consideration of this approach is necessary to ensure that a taxpayer would not lose or limit his recourse to the Canadian CA. An alternative, which may simplify the process considerably, would be to not preclude taxpayers from obtaining CA assistance in cases where reassessments are based on anti-avoidance transactions. We would suggest that Paragraph 38 of the Draft IC be deleted and that, instead, the decision as to whether to negotiate a given CA request be made on a case-by-case basis.

### **CA Proceedings without Taxpayer's Consent**

Paragraph 7 of the Draft IC, which provides that the Canadian CA has the right to initiate CA proceedings without the consent of the taxpayer, appears to clash with the well-established practice recognized at Paragraph 43, which states that a taxpayer has the right to reject a CA agreement if the taxpayer is not satisfied with the agreement negotiated by the CA.

We would not be concerned if Paragraph 7 provided that the Canadian CA may act where it identifies an instance of double taxation not in accordance with the applicable Canadian tax convention that impacts more than one taxpayer. If Paragraph 7 is intended to allow the Canadian CA and its foreign counterpart to enter into discussions and reach agreement on a given issue (such as the proper interpretation of certain terms of a treaty or whether to negotiate on certain types of transactions), even where no taxpayer has requested CA assistance on that issue, we suggest that Paragraph 7 be revised to include a reiteration of the taxpayer's right to accept or reject a CA agreement reached in their particular case.

### **Collections**

Paragraph 35 of the Draft IC provides that a request for CA assistance does not suspend the collection actions of the CCRA with respect to an assessment or reassessment. We consider subjecting a taxpayer to immediate collection action, where such a taxpayer has requested CA assistance, to be unfair. Accordingly, we suggest revising Paragraph 35 to state that collection action will be suspended during the CA process until 90 days after either the CA agreement resulting from the taxpayer's CA request has been communicated to the taxpayer or the inability to reach such agreement has been communicated to the taxpayer.

### **Waivers**

Under the Draft IC, taxpayers are responsible for ensuring that any tax year affected by a CA request does not become statute-barred.<sup>6</sup> Complying with this provision is

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<sup>6</sup> Paragraph 24 of the Draft IC.

problematic since the statute-barring provisions of the ITA related to transfer pricing (subparagraph 152(4)(b)(iii) ITA) do not work in tandem with the waiver provisions (subparagraph 152(4)(a)(ii) ITA). While reassessments may be raised (and thus an audit may continue) up to seven years after the day of the mailing of the notice of original assessment, waivers can only be filed within the “normal reassessment period”<sup>7</sup> (for corporations, generally four years after the mailing of the notice of original assessment). Thus, under certain circumstances, the taxpayer could be powerless to comply with the requirements of Paragraph 24. We recommend that the Canadian CA indicate that, until the waiver provisions of the ITA are properly coordinated with the statute-barring provisions of the ITA as they relate to transfer pricing transactions, the Canadian CA will make such adjustments as are necessary to reverse a CCRA-proposed adjustment where the following conditions are found:

- the CCRA has proposed the impugned adjustment after the expiry of the period for the taxpayer to file a waiver with respect to the relevant taxation year;
- the taxpayer has properly requested CA assistance; and
- the CA process and resulting Canadian reassessment cannot be implemented before the expiry of the period set forth in subparagraph 152(4)(b)(iii) of the ITA.

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<sup>7</sup> Section 152(3.1) of the Income Tax Act.