The Joint Committee on Taxation of
The Canadian Bar Association and
The Canadian Institute of Chartered Accountants

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Mr. Jim Gauvreau
Director
Competent Authority Services Division
International Tax Directorate
Canada Customs and Revenue Agency
5th Floor, 344 Slater Street
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Dear Mr. Gauvreau:

Re: Requests for Competent Authority Assistance-- Draft IC 71-17R5

We are pleased to have the opportunity to comment on the draft IC 71-17R5 "Request for Competent Authority Assistance Under Canada's Income Tax Conventions" (the "**Draft IC**")

The CCRA must be complimented on its efforts to provide more detailed information on a process that remains a mystery for many taxpayers. In our view the competent authority process is a very valuable service that taxpayers may fail to use because of ignorance or misconception. Overall we believe that the Draft IC is a welcomed improvement on the existing IC 71-17R4.

General Comments

The Draft IC contains detailed information on the Canada–U.S. Income Tax Convention. We understand that the majority of Canadian competent authority cases involve the United States. However, we are also aware that increasing numbers of competent authority requests involve other countries. We would therefore like to see more discussion of policy issues involving tax conventions with Canada's other treaty partners (i.e. what normally constitutes proper notification, issues related to the different statutes of limitation).

Specific Comments

1. Appeals Process and Competent Authority Settlements

Under the previous policy, the CCRA would not vary an Appeals settlement in its competent authority negotiation with treaty partners. As evidenced by the Draft IC, the CCRA has changed its position on this matter. The Draft IC states that, in cases where the Appeals Branch has rendered a decision, the CCRA will now negotiate with treaty partners, but will give substantial weight to the findings of the Appeals Branch.

We would like to commend the CCRA for putting this position forward in the Draft IC with respect to the Appeals process, which is welcomed from a taxpayer's standpoint. We think that this is in line with tax policy in general, allowing taxpayers to have access to an objective review of the audit position without jeopardizing taxpayers' rights to the competent authority process.

We have a minor observation with respect to paragraph 30 of the Draft IC which states that the Canadian competent authority will give substantial weight to the findings made by the Appeals Branch with regard to, *inter alia*, provisions of the treaty. From our experience we have found that it is rather seldom, if at all, that the Appeals Branch makes findings with respect to the provisions of the applicable treaty.

2. Complete Competent Authority Requests and Taxpayer Co-operation

Paragraph 16 of the Draft IC is a good indication of what taxpayers should strive to include in a competent authority request. We presume the more complete the request, the more likely it is that relief will be granted and the more expeditiously it will be handled.

In paragraph 27 of the Draft IC it states that the CCRA may request information in addition to that requested during an audit and may request information that was requested but not provided during an audit. The implication is that double taxation may result if such information is not provided.

While we generally agree with the need for taxpayers to present CA requests, which are complete and accurate, we are concerned with the introduction of the notion of taxpayer co-operation as currently presented in the Draft IC.

More specifically, the effect of paragraphs 18, 20 and 27 appears to potentially bring the competent authority very close to performing an audit function. In particular, the fact that the Canadian competent authority may request information which was not requested during an audit or that was requested but not provided during such audit, and that a taxpayer's failure to provide such information may have direct consequences on whether such taxpayer will obtain relief, seems to fall outside the traditional role of competent authority and into a much more "aggressive" role. Indeed, in the past, we were of the understanding that the Canadian competent authority would not attempt to re-do the audit. If this were to occur it could tend to make the competent authority process much more adversarial and difficult.

In any case we would appreciate the CCRA clarifying whether this position to request additional foreign based information and documents in the competent authority process applies to requirements for information issued under section 231.6 of the *Income Tax Act* (the **"Act"),** and if this is the case, the rationale for such a position. Subsection 231.6(8) of the Act, which specifies the consequences for not complying with the requirement, makes no reference to the competent authority process.

3. Timing Issues Related to the Filing of Waivers

The Draft IC repeatedly highlights the importance of taxpayers protecting their positions for the relevant years in both countries by filing appropriate waivers (paragraphs. 18(c), 23, 24, 25 and 26). At paragraph 26, the Draft IC states that the CCRA will not rescind a Canadian adjustment solely because the related foreign taxpayer is beyond the statute-barred date in the foreign jurisdiction.

We agree that taxpayers have a responsibility to file a competent authority request on time in accordance with the terms of the relevant tax convention. However, we also believe that tax administrations have a responsibility to re-assess taxpayers within a reasonable time frame. This becomes a more important issue when Article IX Related Persons of the relevant convention does not specify a time limit for processing adjustments.

Canada has one of the longest statute of limitation periods for international adjustments involving corporations (6 or 7 years after the day of mailing of the notice of original assessment—therefore practically 8 years after the end of the taxation year). Most of our treaty partners have much shorter limitation periods. Therefore when the CCRA issues a reassessment covering 6 or 7 years, in many situations some of the taxation years reassessed will be statute-barred in the other country. If the relevant convention does not specify a time limit to process adjustments, and the other country adopts a position similar to that of Canada (paragraph 26), double taxation will result. In fact, the only practical way for taxpayers to protect themselves against such a situation would be to file waivers in the other country for every return that they file and keep those years open until they become statute-barred in Canada.

We do not consider this a practical and reasonable approach. Ideally, we suggest instead that the conventions be revised to specify a period in which tax administrations may process adjustments and/or a period in which taxpayers may file a request for competent authority assistance (like the one we find in most conventions entered into by Canada which is 2 years after being notified of an adjustment). Alternatively, the onus should be placed on the tax administrations to process adjustments before the taxation years become statute-barred in the other country. In cases where a taxation year is statute-barred in the other country at the time an adjustment is processed, the tax administration that processed the adjustments and created the double taxation should reverse its adjustment to eliminate the double taxation.

In addition, it would be much easier for taxpayers to ensure that the taxation years affected by a competent authority request do not become statute-barred from a Canadian tax perspective if the statute-barring provisions of the Act related to transfer pricing (subparagraph 152(4)(b)(iii) of the Act) worked in tandem with the waiver provisions (subparagraph 152(4)(a)(ii) of the Act). Currently, 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"[1] (for corporations, generally four years after the mailing of the notice of original assessment). On this point, we would urge the CCRA to request an amendment from Finance.

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[1] Subsection 152(3.1) ITA.

4. Tax Collections Continue During Competent Authority Proceedings

The Act contains provisions that reduce or eliminate the amount of tax to be paid by taxpayers following a reassessment when they object to it.

We are of the view it is unfair that taxpayers be subjected to collection action where they have requested competent authority assistance and request a change in policy which would state that collection action of Part I and related Part XIII taxes will be suspended during the competent authority process and will not start until 90 days after a competent authority agreement has been communicated to the taxpayer. A legislative amendment would be necessary to give effect to this recommendation.

5. Anti-Avoidance Rules a bar to Competent Authority Assistance

Paragraph 38 of the Draft IC indicates that the Canadian competent authority will not negotiate cases where the primary position of a Canadian-initiated reassessment was made under anti-avoidance sections of the Act. We are generally concerned about situations where one tax authority may deem certain transactions to exist (for instance, through a power of recharacterization such as paragraphs 247(2)(b) and (d) of the Act) where no such transactions was intended by the parties nor, in fact, existed at the time and where the foreign tax authority on the other side of the transaction may take a different view. In our view, these types of situations create potential structural irremediable double taxation.

We submit that a better policy might be to deal with adjustments based on anti-avoidance provisions of the Act on a case-by-case basis as it relates to providing competent authority relief rather than sticking to an outright refusal to entertain such cases.[2]

As the position currently reads in the Draft IC, a taxpayer may be forced to go to the Tax Court of Canada and the court could rule that anti-avoidance provisions of the Act were not applicable. Of course, if taxpayers are forced to go to the court to confirm that anti-avoidance provisions of the Act were not applicable, they will be facing "double jeopardy" since the Canadian competent authority would probably then rely on paragraph 32 of the Draft IC and would not be willing to negotiate from the result obtained in court.

In our view it is unfair to force the taxpayer to go to court to obtain confirmation that anti-avoidance provisions of the Act do not apply in order to be able to put the matter before the Canadian competent authority, and yet, deny the full benefit of the competent authority process because a court decision has been rendered. We recommend that the Draft IC state that the CCRA will agree to bring a case to competent authority and negotiate with the other tax administration if Appeals or the courts ultimately rule that anti-avoidance provisions of the Act have not been offended.

6. Competent Authority Proceedings Without Taxpayer Consent

In paragraph 7, the Draft IC observes that the CCRA has the right to initiate competent authority proceedings and subsequent negotiations without the request or consent of a taxpayer in any situation where the interests of Canada are affected.

It is a general belief that, except for articles relating to the prevention of tax avoidance, such as the article on the exchange of information with treaty partners, tax conventions exist to provide relief to taxpayers and are not intended to be used to raise new taxes. Furthermore, as it currently reads paragraph 7 seems to clash with the well-established practice recognized at paragraph 43 of the Draft IC: a taxpayer has the right to reject a competent authority agreement.

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[2] Paragraph 38 of the Draft IC.

Perhaps what is meant by paragraph 7 is that, even where no taxpayer has requested competent authority assistance on a given issue, the Canadian competent authority and its foreign counterpart may nonetheless enter into discussions and reach agreement on issues (such as the proper interpretation of certain terms of a treaty or whether to negotiate on certain types of transactions). However, it should be made clear that this does not affect the right of taxpayers to accept or reject competent authority agreements reached in their particular files.

In any event it would be helpful if the CCRA could clarify its views on this topic and perhaps provide examples of situations where "the interests of Canada could be affected".

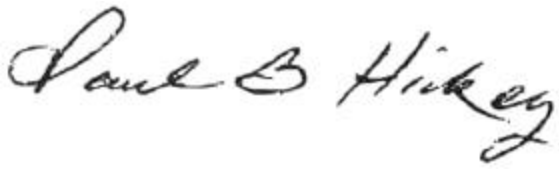
7. Corresponding Adjustments as distinct from Compensating Adjustments

Paragraph 21 of the Draft IC indicates that taxpayers should not make claims for corresponding adjustments or foreign tax credits for foreign tax administration adjustments on the filing of Canadian income tax returns (current or amended) without first seeking assistance from the Canadian competent authority. We agree that it is a good idea to clearly state that corresponding adjustments can only be made with the assistance of the Canadian competent authority. In order to eliminate any possible confusion here we suggest that it would be helpful to perhaps add one sentence to this paragraph to indicate that corresponding adjustments are not the same as compensating adjustments (which are acceptable in certain situations and must occur prior to filing the tax return for the relevant taxation year). Compensating adjustments which are specifically addressed in other pronouncements (e.g. in IC 87-2R and IC 94-4R) and do not need competent authority involvement.

Conclusion

In summary, we are of the view that the Draft IC is a welcomed step in the right direction in providing guidance to taxpayers on the competent authority process. We are very supportive of this project and stand prepared to offer our assistance to you in discussing or clarifying any of the points raised above. We encourage you to finalize this Draft IC as soon as possible.

Yours sincerely,



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