

BUDGET 2013: INTERNATIONAL TAX COMPLIANCE

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Budget 2013 contained a number of international compliance measures designed to limit the incidence of non-compliance and evasion with regards to taxpayers' international activities. Several of these measures aim to improve the information gathering capacity of the Canada Revenue Agency (the "**CRA**") and to increase the consequences of failing to comply with taxpayers' Canadian tax obligations. Budget 2013 also announced the Government's intention to release a consultation paper on "treaty shopping" that would consider approaches to limiting the perceived abuse of Canada's network of bilateral tax treaties.

international electronic funds transfers

Budget 2013 announced the Government's intention to grant the CRA certain additional information gathering powers to better track electronic transfers of money that cross Canada's international borders. The Government expects that these powers will permit the CRA to better understand the international financial activities of Canadian taxpayers to better ensure compliance with certain of Canada's taxing statutes.

Certain Canadian financial intermediaries are already obliged to report international electronic funds transfers ("**IEFTs**") of \$10,000 or more to the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) pursuant to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (Canada). Such financial intermediaries generally include banks, credit unions, caisses populaires, trust and loan companies, money service businesses and casinos (collectively, "**Financial Institutions**").

Budget 2013 proposes to amend the *Income Tax Act* (Canada) (the "**Tax Act**"), the *Excise Tax Act* (Canada) and the *Excise Act, 2001* (Canada) to also oblige Financial Institutions to report IEFTs of \$10,000 or more to the CRA. A Financial Institution reporting an IEFT to the CRA will be required to supply information on the person conducting the transaction, on the recipient of the funds, on the transaction itself and on the Financial Institutions facilitating the transaction. Such information must be provided to the CRA no later than five business days after the day of the transfer.

Curiously, the Government has placed the obligation on Financial Institutions to report information to the CRA rather than obliging FINTRAC to share such information with the CRA directly. This arguably places an administrative burden on the part of Financial Institutions that might more efficiently have been addressed by

permitting information sharing between these two branches of the federal government.

Financial Institutions will be obliged to report such IEFTs to the CRA beginning in 2015.

information requirements regarding unnamed persons

Budget 2013 proposes measures intended to streamline the procedure the CRA must follow to obtain information on unnamed third parties under its broad investigatory powers.

Currently, the CRA may not require a person to provide information about unnamed third parties without first receiving judicial authorization (i.e., a court order). To obtain such a court order, the CRA must establish that (i) the unnamed person or group of persons is ascertainable, and (ii) the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under the Tax Act. The obligation to obtain such a court order is generally perceived as protection against the CRA engaging in "fishing expeditions".

The Tax Act currently permits the CRA to obtain such judicial authorization on an *ex parte* basis (i.e. without the party from whom the information will be requested being notified of the court proceeding). As a counterbalance to the inherent inequity of acting on an *ex parte* basis, the Tax Act permits the party subject to the requirement to apply to have it extinguished or varied within 15 days after service of the request for information. The Government has indicated that such review hearings can cause a significant delay in obtaining the requested information.

The Budget Papers state that the Government rarely obtains judicial authorization to obtain information on unnamed third parties on an *ex parte* basis. Accordingly, Budget 2013 proposes to eliminate both the CRA's authority to obtain such judicial authorizations on an *ex parte* basis and the right of the party subject to the requirement to have such a judicial authorization extinguished or varied after service. Instead, the CRA will be obliged to give notice to a person being requested to provide information about unnamed third parties of any proposed authorization hearing before the Federal Court. The proposed amendments to the Tax Act do not otherwise affect the rights of either party to make an appeal to the Federal Court of Appeal where available.

The proposed amendments to the procedure for obtaining documentation on unnamed persons will apply in respect of requests made after the enacting legislation has received Royal Assent.

foreign reporting – T1135s

Canadian-resident individuals, corporations, trusts and certain partnerships that, at any time during a year, own "specified foreign property" with an aggregate cost amount in excess of \$100,000, are required to file CRA Form T1135, *Foreign Income Verification Statement* (a "**Form T1135**") with the CRA by the legislated deadline. The Tax

Act defines "specified foreign property" to include most types of income-earning property held outside of Canada, other than certain listed exceptions including personal property, property used in carrying on an active business and shares in certain foreign affiliates.

Budget 2013 proposes certain amendments to (i) the content of Form T1135, and (ii) the consequences of failing to file a Form T1135 if required to do so.

a) revised form T1135

Form T1135 currently requires general information about the geographic region in which specified foreign property is located and the income such specified foreign property generates. Budget 2013 proposes revisions to Form T1135 that would require taxpayers to provide a greater level of detail about their specified foreign property. It is proposed that the revised Form T1135 will require taxpayers to provide more specific information regarding each specified foreign property including:

- the name of the specific foreign institution or other entity holding funds outside of Canada;
- the specific country to which the property relates; and
- the foreign income generated from the property.

It is expected that the additional detail provided to the CRA on the proposed Form T1135s will allow the CRA to better administer the tax system and identify foreign non-compliance. Unfortunately, taxpayers will bear the burden of increased compliance costs.

b) extended reassessment period

Budget 2013 proposes to extend the period during which the CRA may reassess a taxation year if a Form T1135 was not properly filed.

Subject to certain exceptions, the CRA is not permitted to reassess a taxpayer outside of the "normal reassessment period". For mutual fund trusts and corporations other than Canadian-controlled private corporations, the "normal reassessment period" in respect of a particular taxation year generally continues for four years after the sending of the original notice of assessment in respect of that year. For other taxpayers, the "normal reassessment period" in respect of a particular taxation year generally extends for three years after the sending of the original notice of assessment in respect of that year.

Budget 2013 proposes to extend the reassessment period for taxpayers for an additional three years for taxpayers that have either (i) failed to file a Form T1135 as and when required, or (ii) failed to report on Form T1135 information required in respect of a specified foreign property held by the taxpayer at any time during that year. Under the proposal, the CRA may only reassess during the additional three year reassessment period

if the taxpayer has failed to report an amount in respect of a specified foreign property that is required to be included in computing the taxpayer's income in respect of the applicable year.

Under proposed amendments, it would appear that the extension of the reassessment period is three years notwithstanding that the Form T1135 may be late by less than three years. Accordingly, it is possible, as currently drafted, that a reassessment period could be extended by three years notwithstanding that the Form T1135 was only late by a *de minimus* period of time. It remains to be seen whether the legislation will be enacted as currently proposed or whether it will be amended to avoid such a harsh result.

It is proposed that the amendments to the reassessment period discussed above are to apply to the 2013 and subsequent taxation years.

stop international tax evasion program

Budget 2013 proposes to launch the *Stop International Tax Evasion Program* pursuant to which the CRA will pay rewards to persons that notify the CRA of major international tax non-compliance. It is proposed that the CRA will be permitted to enter into contracts with "whistle blowers" to pay 15% of the federal tax collected (excluding penalties, interest and provincial taxes), conditional upon (i) the additional assessment or reassessment exceeding \$100,000 in federal tax, and (ii) the non-compliant activities involving foreign property or property located or transferred outside Canada, or transactions conducted partially or entirely outside Canada.

In proposing such a "bounty" or "whistle blower" program, the Government is following the lead of several other countries that have already established comparable programs, including the United States. The CRA will announce further details about the program at a later date.

treaty shopping

Canada has entered into a wide network of bilateral tax treaties that limit instances of double taxation and reduce the rates of withholding taxes imposed on various cross-border payments. Generally, the benefits of such treaties are limited to residents of the contracting states. However, the Government has observed that residents of jurisdictions that do not have a bilateral tax treaty with Canada are able to indirectly access the preferential treatment available under such treaties by establishing corporations, or other entities, that are resident in a treaty jurisdiction. The Government has referred to this practice as "treaty shopping".

The Government has attempted a variety of approaches to combat "treaty shopping". For example, the Government has amended the general anti-avoidance rule in section 245 of the Tax Act such that it applies to bilateral tax treaties. The Government has also attempted to deter "treaty shopping" by challenging such arrangements in the Courts. The CRA, however, has been largely unsuccessful with such challenges. [1]

The Government has also amended tax treaties to limit the scope for "treaty shopping". Such amendments have been either of a general nature or of more limited scope. For example, the *Canada-U.S. Income Tax Convention* contains a broad "limitation on benefits" clause limiting access to treaty benefits. Conversely, Canada has negotiated other treaties where the "anti-treaty shopping" prohibitions were of more limited scope.^[2] Although the Government has had some success in combating "treaty shopping" by amending the terms of its bilateral tax treaties, the process for amending each of Canada's treaties is expected to be time consuming and laborious.

Accordingly, the Government announced its intention in Budget 2013 to consult on other possible measures to discourage "treaty shopping". A consultation paper will be publicly released to provide stakeholders with an opportunity to comment.

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[1][ps2id id='1' target=''] See, for example, *Prévost Car Inc v R*, 2009 FCA 57 and *Velcro Canada Inc v R*, 2012 TCC 57.

[2][ps2id id='2' target=''] See, for example, the *Canada-Hong Kong Income Tax Convention* (not yet in force).

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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