CRA ROUNDTABLE

Moderators:

Grace Chow, Cadesky Tax, Toronto

Ken Saddington, Goodmans LLP, Toronto

Speaker:

Yves Moreno, Director, International Division, Income Tax Rulings Directorate, LPRAB, Canada Revenue Agency (CRA)

Question 1 – Section 247 & Recent Changes Regarding Stock-Based Compensation

- CRA has traditionally not allowed inbound charges for stock option expenses incurred by related parties to be deducted by a Canadian taxpayer when the cost of such stock options is included in the cost of services provided by the related non-resident person
- There are revised rules in Canada allowing, in certain situations, deductions of non-qualified stock option expenses

Question 1 – Section 247 & Recent Changes Regarding Stock-Based Compensation

In this context, can CRA comment on the following:

- Will CRA now expect that Canadian taxpayers include stock option expenses in the cost base for services charged to related non-residents, where the employees providing the services to the related non-residents received employer-deductible stock options?
- If "Yes", will CRA provide reciprocity on inbound stock-based compensation charges if the circumstances are similar?

Question 2 – Ukraine/Russia Reporting Requirements

- Some Canadian multinationals have subsidiaries in Ukraine or Russia that have continued operating during 2022
- Due to the war, financial reporting from these subsidiaries may not be available for 2022
- Will CRA grant any administrative relief in relation to the reporting requirements of Canadian multinationals covering their subsidiaries in Ukraine or Russia with respect to tax reporting covering international operations, such as country-by-country reporting, forms T1134, etc.?
- What is the CRA's position with respect to such cases?

Question 3 – T1134 Supplement Disclosure on Dividends

Part II Section 3(A)(2) of the T1134 supplement requires disclosure of dividends paid by a foreign affiliate

2. Indicate the amount of all dividends paid by the foreign affiliate

	Amount	Currency code
Dividend in Cash or in Kind		
Stock Dividend		

3. Was the foreign affiliate involved in any transaction in respect of which subsections 93(1.11) or (1.3) applied? .... Yes ☐ No ☐

Question 3 – T1134 Supplement Disclosure on Dividends

Could CRA please comment on the following:

1) Is the definition of dividends based on Canadian or foreign corporate/tax principles?
   - How does the disclosure apply to a US LLLP or LLC that is a foreign affiliate – corporation for Canadian tax purposes but fiscally transparent or partnership under US tax law
     - Distributions from these entities are not considered dividends for U.S. purposes and not shown as dividends on the financial statements for US purposes
     - Subsection 90(2) of the *Income Tax Act* (the "Act")deems pro-rata distributions from these entities to members as dividends

Question 3 – T1134 Supplement Disclosure on Dividends

Could CRA please comment on the following:

2) If Canadian principles are to be used and the taxpayer does not have information on whether the distributions are made on a pro-rata basis, would the due diligence exception under Part IV be available?

Question 4 – Canada-Barbados Treaty – “Special Tax Benefit”

Paragraph 3 of Article XXX (Miscellaneous Rules) of the Canada-Barbados Income Tax Convention (the “**Treaty**”) provides:

3. *The provisions of Articles VI to XXIV of this Agreement shall not apply to any person or other entity entitled to any special tax benefit:*

a) *in Barbados, under the International Business Companies Act, the Exempt Insurance Act, the Insurance Act, the International Financial Services Act, the Society With Restricted Liability Act, or the International Trusts Act, or any substantially similar law subsequently enacted; or*

b) *in either Contracting State, under a law of that State which has been identified in an Exchange of Notes between the Contracting States.*

Question 4 – Canada-Barbados Treaty – "Special Tax Benefit"

- Barbados has abolished its Exempt Insurance Company and Qualifying Insurance Company regimes

- Barbados general corporate income tax rates currently are based on taxable income as follows:
  - 5.5% on the first BBD 1 million;
  - 3% on BBD 1,000,001 to BBD 20 million;
  - 2.5% on BBD 20,000,001 to BBD 30 million; and
  - 1% on amounts in excess of BBD 30 million

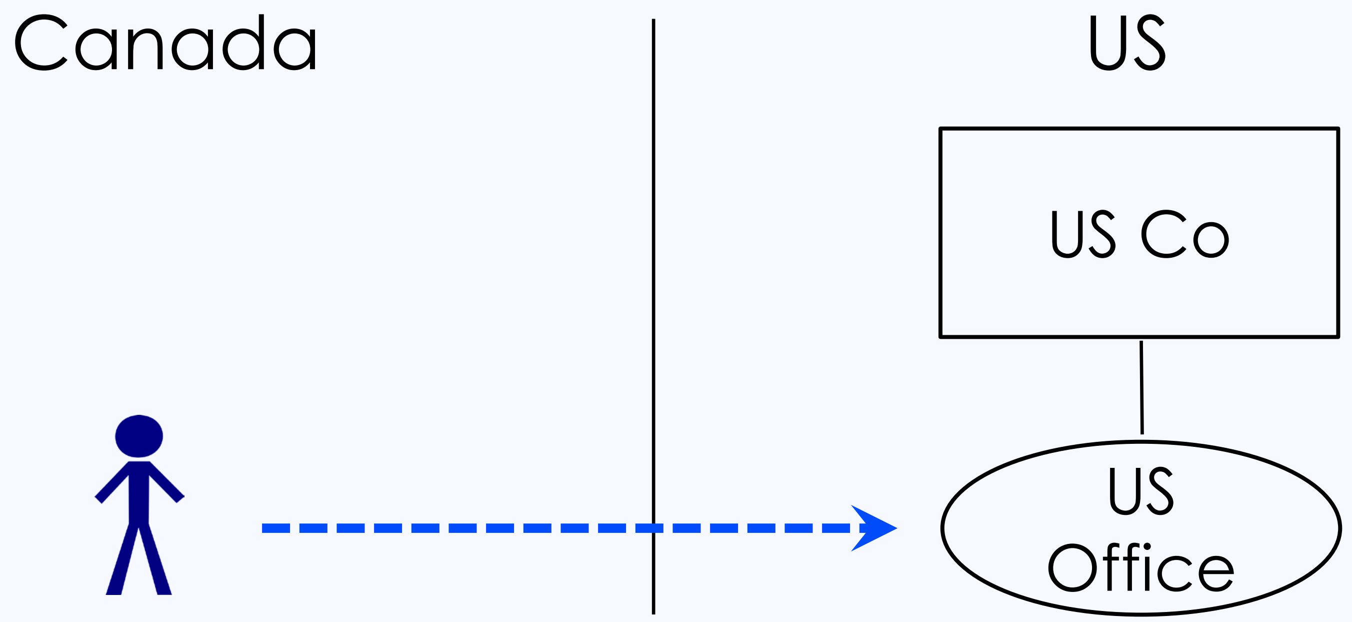
- Under the *Insurance Act, Cap. 310* (Barbados), a Class 2 licence entitles the company to insure third-party risks wherever situated. The corporate tax rate on all insurance companies with a Class 2 licence is 2%

Question 4 – Canada-Barbados Treaty – “Special Tax Benefit”

Does Article XXX(3) of the Treaty exclude such an insurance company from the listed benefits of the Treaty? In other words, does the 2% rate constitute a "special tax benefit" within the meaning of Article XXX(3) of the Treaty?

Question 5 – US Employers with Canadian Employees

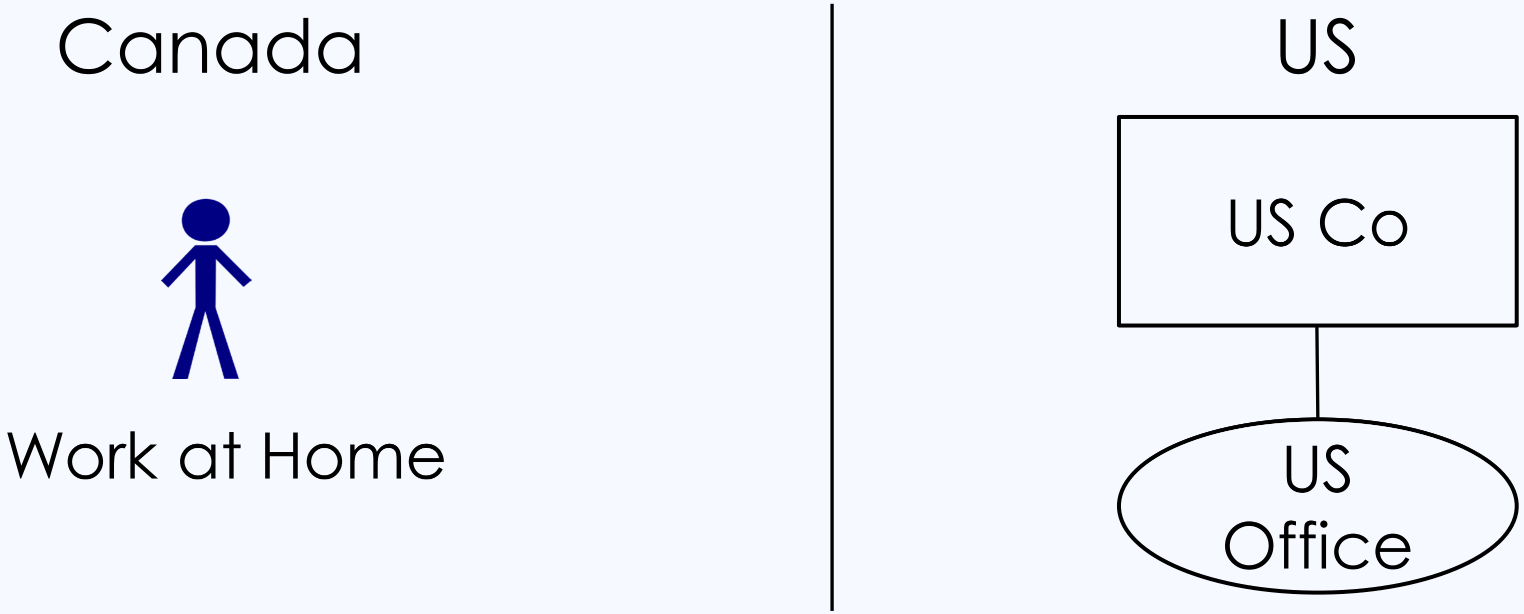
Traditional Work Arrangements



Canadian employees travel to work at US office

Question 5 – US Employers with Canadian Employees

Remote Work Arrangements



Canadian employees allowed to work at home

Question 5 – US Employers with Canadian Employees

Consider the following scenario:

- USco was formed under the laws of the U.S. as a C-corporation that is taxed in the U.S. as a separate taxpayer on a worldwide basis
- USco is a resident of the U.S. for purposes of the Canada-U.S. Income Tax Convention (the "**Treaty**")
- USco is entitled to benefits under the Treaty (i.e., USco is a "qualifying person" for purposes of Article XXIX-A of the Treaty)
- 50 of the 1,000 USco employees are Canadian residents
- The employees are allowed, but not required, to work from home for two or three days a week

Question 5 – US Employers with Canadian Employees

Could CRA please comment on the following:

Whether USco may be considered to be

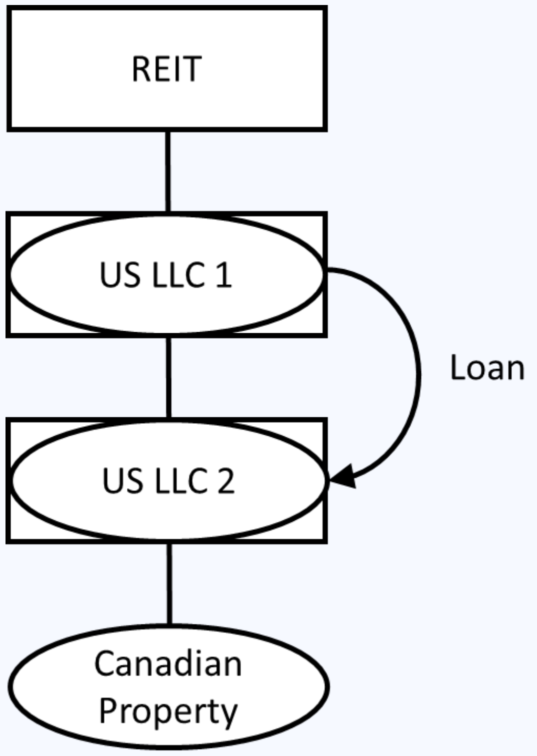
i. carrying on business in Canada for purposes of the Act, and, if so
ii. earning income through a permanent establishment (as defined for purposes of the Treaty) in Canada

Question 6 – Application of the Hybrid Rules in the Canada-US Treaty

Consider the following Scenario, depicted on the following slide:

- A U.S. resident corporation has elected to be classified as a "real estate investment trust" ("**REIT**") under the U.S. Internal Revenue Code (the "**Code**"), and is a regarded entity for U.S. income tax purposes. REIT is a U.S. resident and a "qualifying person" for purposes of the Canada-U.S. Income Tax Convention (the "**Treaty**")
- REIT owns US LLC 1, a disregarded entity for U.S. income tax purposes
- US LLC 1 owns US LLC 2, which is also a disregarded entity for U.S. income tax purposes and a section 216 taxpayer for Canadian income tax purposes
- Neither US LLC 1 nor US LLC 2 is a resident of Canada for the purposes of the Treaty
- US LLC 1 makes an interest-bearing loan to US LLC 2. The loan is incurred in connection with US LLC 2's real estate operations in Canada, which constitutes its permanent establishment in Canada. Interest on the loan is borne by the permanent establishment
- Interest on the loan is subject to Canadian Part XIII withholding tax (either as a result of the application of paragraph 212(13)(f) or proposed paragraph 212(13.2)(b))

Question 6 – Application of the Hybrid Rules in the Canada-US Treaty

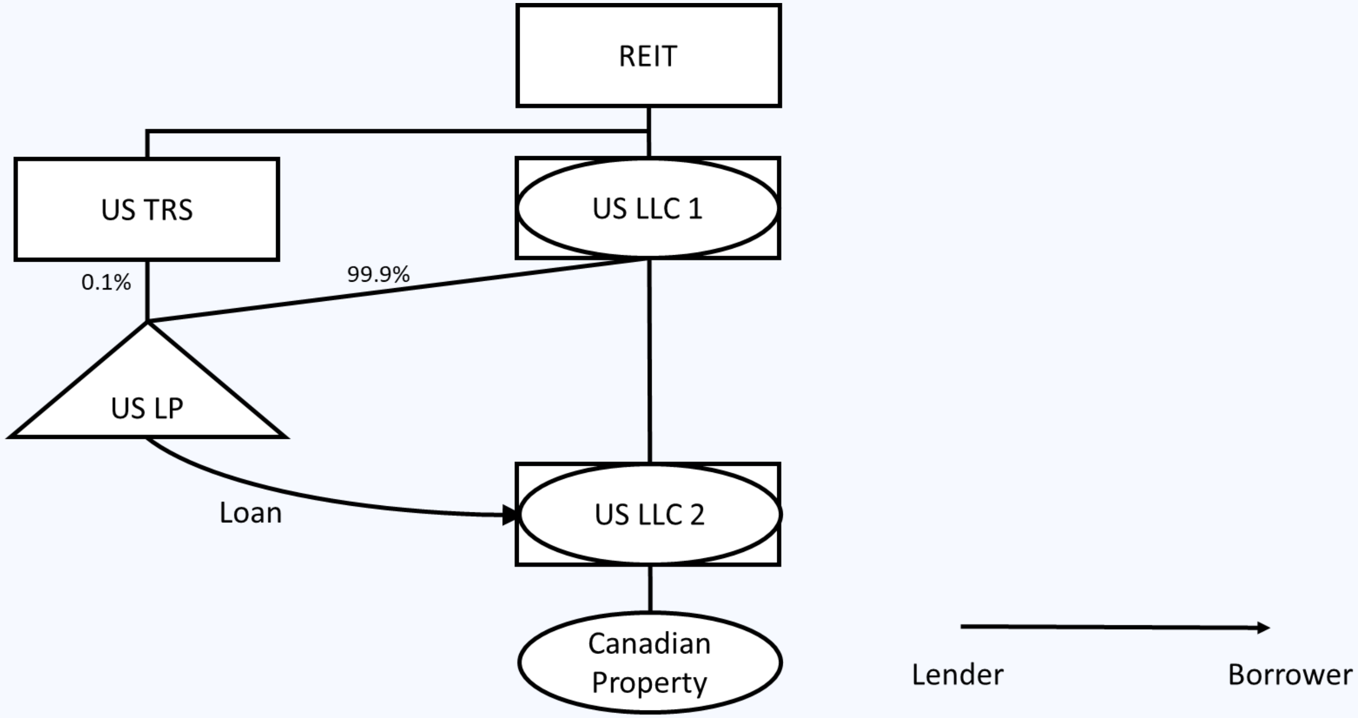


Question 6 – Application of the Hybrid Rules in the Canada-US Treaty

- The CRA has previously stated that where a ULC makes payments to a U.S. LLC and both are disregarded for US tax purposes, Article IV(6) of the Treaty would not apply to treat a particular amount of Canadian-source income, profit or gain as being derived by the U.S. member(s) of the LLC where that amount is “disregarded” under the taxation laws of the U.S. (Technical Interpretation 2012-0434311E5)
- The same conclusion would apply in the given example, such that interest payments from US LLC 2 would not be eligible for relief under the Treaty
- Can the CRA comment on the applicability of the Treaty to relieve interest payments by US LLC 2 from Part XIII withholding tax in the scenarios described below?

Question 6 – Application of the Hybrid Rules in the Canada-US Treaty

Scenario 1
Creating a Regarded Interest Recipient



Question 6 – Application of the Hybrid Rules in the Canada-US Treaty

Scenario 1

- REIT incorporates a new corporation ("**US TRS**") with nominal share capital. REIT and US TRS jointly elect to treat US TRS as a taxable REIT subsidiary under the Code. US TRS is a taxable corporation (and is regarded) for U.S. income tax purposes
- US TRS is a U.S. resident and a "qualifying person" for purposes of the Treaty
- Neither REIT nor US TRS carries on business in Canada through a permanent establishment
- US LLC 1 and US TRS form US LP, a limited partnership formed under the laws of the US. US TRS holds a 0.1% general partner interest, and US LLC 1 holds a 99.9% limited partner interest in US LP

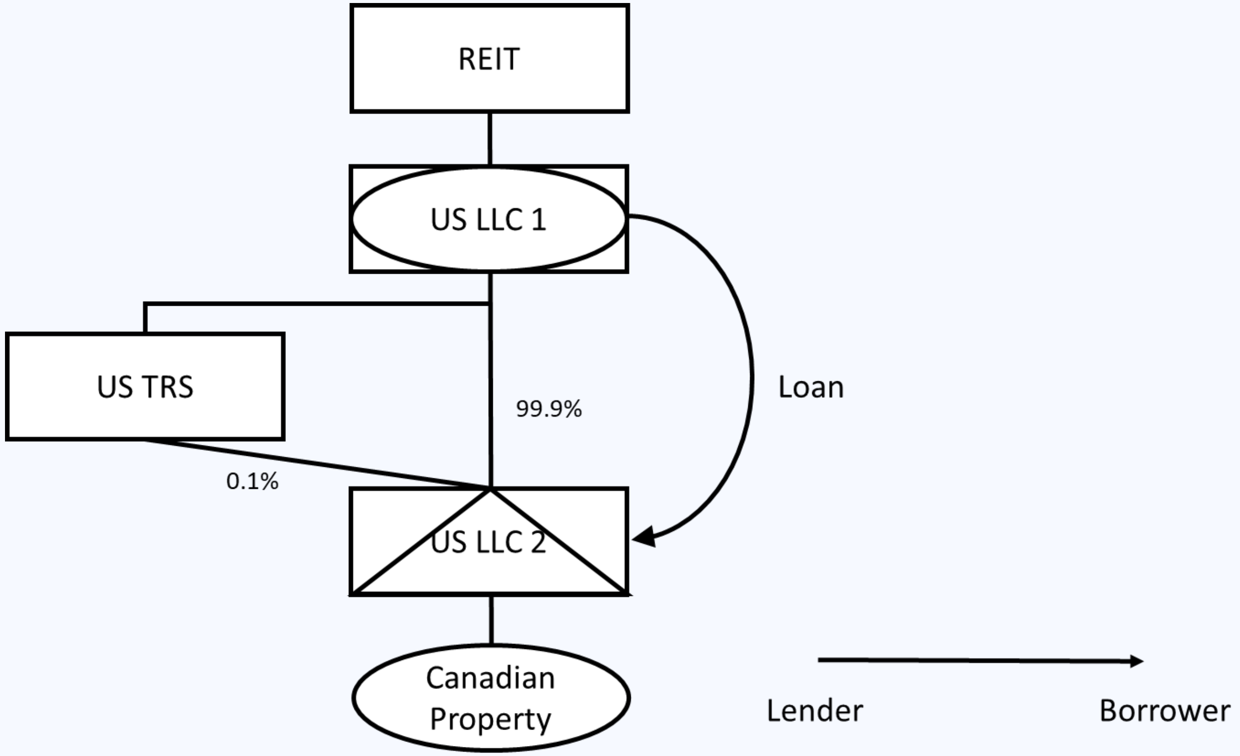
Question 6 – Application of the Hybrid Rules in the Canada-US Treaty

Scenario 1

- US LP is considered a flow-through entity for U.S. income tax purposes, but is not disregarded
- US LP, rather than US LLC 1, makes an interest-bearing loan to US LLC 2
- For U.S. income tax purposes, interest paid by US LLC 2 to US LP is viewed as interest paid by REIT to US LP and is not disregarded
- On an annual basis REIT and US TRS are allocated interest income received by US LP in proportion to their partnership interests and include it in computing their taxable income for U.S. income tax purposes

Question 6 – Application of the Hybrid Rules in the Canada-US Treaty

Scenario 2
Creating a Regarded Interest Payor



Question 6 – Application of the Hybrid Rules in the Canada-US Treaty

Scenario 2

- US LLC 1 incorporates a new corporation ("**US TRS**") with a nominal share capital. US LLC 1 and US TRS jointly elect to treat US TRS as a taxable REIT subsidiary under the Code. US TRS is a taxable corporation (and is regarded) for U.S. income tax purposes
- US TRS is a U.S. resident and a "qualifying person" for purposes of the Treaty
- Neither REIT nor US TRS carries on business in Canada through a permanent establishment
- US TRS subscribes for a 0.1% membership interest in US LLC 2, while US LLC 1 holds a 99.9% membership interest

Question 6 – Application of the Hybrid Rules in the Canada-US Treaty

Scenario 2

- US LLC 2 is treated as a partnership for U.S. income tax purposes, which is a flow-through entity, but is not disregarded for U.S. income tax purposes
- US LLC 1 makes an interest-bearing loan to US LLC 2
- For U.S. income tax purposes, interest paid by US LLC 2 to US LLC 1 is viewed as interest paid by US LLC 2 to REIT and it is not disregarded
- REIT includes the amount of interest received as interest income from US LLC 2 through US LLC 1 in computing its taxable income for U.S. income tax purposes

Question 7 – Hong Kong Canada Income Tax Agreement and Article 7(1) of the MLI

Article 10 paragraph 2 of the Hong Kong-Canada Income Tax Agreement (**Agreement**) provides that the Canadian withholding tax on a dividend paid by a Canadian resident company to a Hong Kong tax resident will be reduced to either:

a) 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) that controls directly or indirectly at least 10% of the voting power in the company paying the dividends (**Article 10(2)(a)**); and

b) 15% of the gross amount of the dividends, in all other cases (**Article 10(2)(b)**)

Question 7 – Hong Kong Canada Income Tax Agreement and Article 7(1) of the MLI

Paragraph 7 of Article 10 (**Article 10(7)**) of the Agreement contains a main purpose test which states as follows:

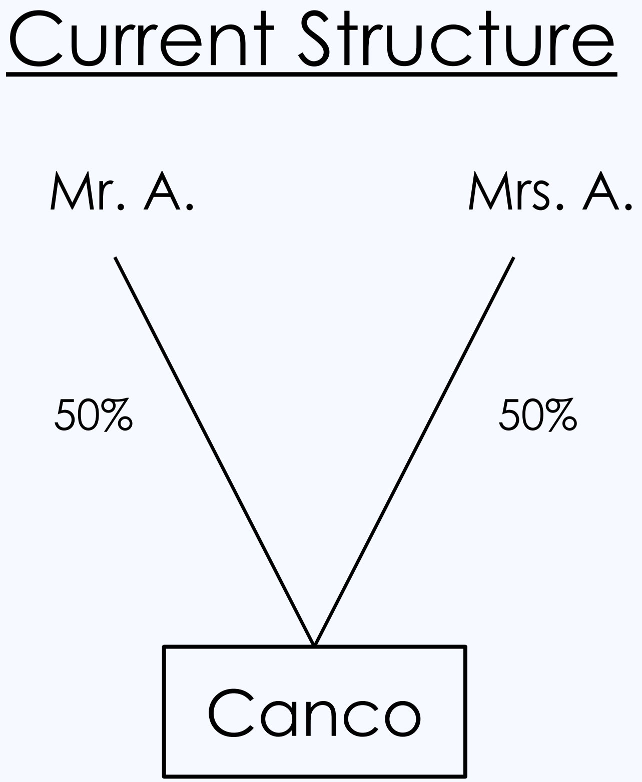
> "***A resident of a Party shall not be entitled to any benefits provided under this Article in respect of a dividend if one of the main purposes of any person concerned with an*** *assignment or transfer of the dividend, or with the creation, assignment,* ***acquisition*** *or transfer* ***of the shares*** *or other rights* ***in respect of which the dividend is paid****, or with the establishment acquisition or maintenance of the person that is the beneficial owner of the dividend,* ***is for that resident to obtain the benefits of this Article***." (Emphasis Added)

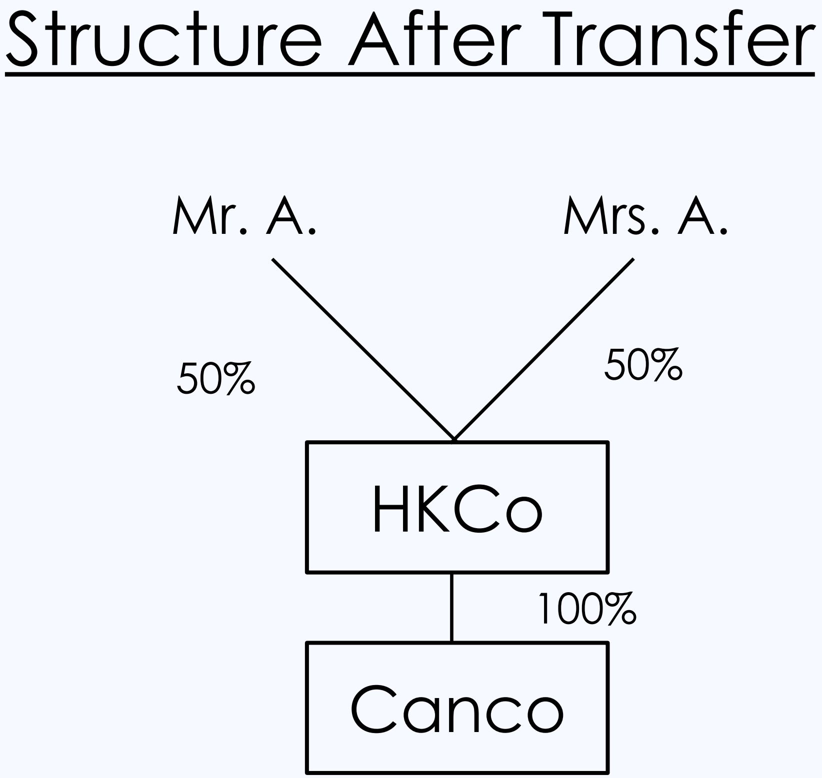
Question 7 – Hong Kong Canada Income Tax Agreement and Article 7(1) of the MLI

Consider the following example:

- Mr. A and his spouse (**Taxpayers**) have been residents of Hong Kong since prior to 2013 and have been resident there since
- The Taxpayers are equal shareholders of a Canadian resident corporation (**Canco**)
- The Taxpayers plan to incorporate a new Hong Kong company (**HKCo**) and will each transfer their shares of Canco to HKCo
- HKCo will own 100% of Canco after the transfer

Question 7 – Hong Kong Canada Income Tax Agreement and Article 7(1) of the MLI





Question 7 – Hong Kong Canada Income Tax Agreement and Article 7(1) of the MLI

Questions:

1) Will dividends paid by Canco to HKCo be eligible for the 5% reduced treaty rate in Article 10(2)(a)?
2) Will the anti-avoidance rule under Article 10(7) of the Agreement apply to deny the benefit of Article 10(2)?
3) If yes, will the withholding tax rate be 15% as available prior to the transactions or 25% as provided without the benefit of a tax treaty?

Question 7 – Hong Kong Canada Income Tax Agreement and Article 7(1) of the MLI

Questions:

4) Will the Multilateral Instrument (**MLI**) have any implications to the withholding tax rate applicable under the Agreement?

Question 8 – Tax-free Surplus Balance Calculation and Paragraph 88(1)(d) “bump”

At the 2011 IFA Conference CRA Roundtable, the CRA indicated that it would not challenge a paragraph 88(1)(d) bump in respect of the shares of a foreign affiliate (**FA**) by raising an issue with an FA’s tax-free surplus balance (**TFSB**) calculation or lack thereof where:

- absent clause 88(1)(d)(ii)(C), the shares of FA could be bumped to fair market value such that there would be no gain on a subsequent distribution of the FA shares to a foreign parent;
- no dividends were paid or were deemed to be paid on the FA shares following the acquisition of control; and
- the FA shares were distributed to the foreign parent within a reasonable amount of time.

(CRA document 2011-0404521C6)

Question 8 – Tax-free Surplus Balance Calculation and Paragraph 88(1)(d) "bump"

Given the CRA's more recent statements on the necessity of computing surplus to support deductions under section 113, can the CRA confirm its prior position regarding tax-free surplus balance and the bump?