Summary of Government Roundtables Session

The Government Roundtables session was moderated by Claire Kennedy of Bennett Jones LLP and Brian Gleicher of White & Case LLP. The session comprised three segments:

1. A technical Q&A with Lori Carruthers, a manager in the International Division of the Canada Revenue Agency ("CRA") Income Tax Rulings Directorate;

2. A dialogue on competent authority between Sue Murray from CRA's Competent Authority Services Division and Patricia Fouts from the Internal Revenue Service's ("IRS") Advance Pricing and Mutual Agreement Program; and

3. A discussion with Steven Musher, Associate Chief Counsel to the IRS, regarding U.S. perspectives on international tax issues.

Technical CRA Q&A

The first segment of the Government roundtables followed a format common to Canadian tax conferences. In this Q&A segment, Lori Carruthers provided clarification of the CRA's views on several technical issues. She answered questions relating to the application of the "foreign affiliate dumping" rules to a guarantee provided by a corporation resident in Canada for no fee, the application of the Limitation on Benefits provision in the Canada-U.S. treaty to a gain on the sale of a U.S. company in a certain situation, the Canadian upstream loan rules, the "at all times" requirement in paragraph 95(2)(i) of the Canadian *Income Tax Act*, and whether the CRA is prepared to grant administrative relief to permit a sale of a foreign affiliate to occur on a tax-deferred basis in the context of an internal reorganization. Owing to time limitations, not all questions were addressed orally. The CRA has released formal written responses to all the roundtable questions and, accordingly, the answers are not summarized here.

Competent Authority Dialogue

Sue Murray and Patricia Fouts began their dialogue by emphasizing the excellent working relationship enjoyed by the Canadian and U.S. competent authorities and their collaborative, results-oriented approach. The two competent authorities now engage in more initial dialogue than before, with the goal of front-loading the resolution process and gaining an early common understanding of the issues and any further information required from taxpayers. In addition, increased communication between their face-to-face meetings has allowed them to make the most of such meetings by using them to focus on the difficult issues.

The above measures, among others, have led to significant increases in efficiency, and corresponding decreases in resolution times, for both competent authorities. For example, the CRA has reduced its average time to resolution of MAP cases to approximately 22 months, below its target of 24 months, and has doubled its APA production. The IRS has also seen improvement, reducing its time to resolution to approximately 23 months for MAP cases and to under three years for APA cases. The competent authorities are currently developing a best practices document that they hope will lead to further improvements.

Ms. Murray and Ms. Fouts then discussed the impact that mandatory "baseball-style" arbitration has had on the mutual agreement procedure. They view arbitration as a last resort and do not believe that it has affected the competent authorities' collaborative approach. However, the introduction of fixed arbitration deadlines into the process has imposed discipline on the competent authorities and forced them to engage in ongoing dialogue rather than deferring difficult decisions. This discipline has likely contributed to the improvements in resolution times described above.

The discussion next turned to the treatment of taxpayer-initiated adjustments. Ms. Fouts affirmed the position taken in a draft competent authority revenue procedure ("rev proc") that the U.S. is open to self-initiated adjustments should its treaty partners wish to engage. However, the rev proc, which is currently open for comment, will not contain an overarching mandate or policy. Ms. Fouts hopes that comments from the taxpayer community will help to develop examples, but taxpayer-initiated adjustments will largely be treated by the U.S. on a case-by-case basis. Ms. Murray confirmed that the CRA is also receptive to taxpayer-initiated adjustments, but will not proceed unilaterally – it will only explore them if the appropriate treaty partner agrees that it is a matter for competent authority and is willing to provide a position paper. This CRA position was stated in an update issued on the CRA website in December 2013.

The final topics of the conversation concerned two different types of files: intangibles migration and stock option compensation. Although the competent authorities engage in dialogue regarding guiding principles, both intangible migration cases and stock option compensation cases are dealt with on a case-by-case basis. Ms. Murray and Ms. Fouts revealed that the majority of difficult cases they face involve intangibles migration, and noted that unique challenges arise from the shared border and strong trade relationship between the U.S. and Canada. Stock option compensation files are dealt with case-by-case because of their fact-specific nature and many moving parts. One significant challenge in such cases is to determine how the stock option compensation has been treated in the taxpayer's financial statements. Once this has been done, the competent authorities then engage in how to quantify and value the compensation, and whether to include it or exclude it based on U.S. and Canadian accounting standards and their treatment of comparable cases.

U.S. perspectives on international tax issues

In the final segment of the Government roundtables, Steven Musher discussed issues relating to FATCA, a recently released roadmap for U.S. transfer pricing audits, and transfer pricing in the context of intangibles.

First, Mr. Musher described how FATCA will apply to foreign pass-through payments, i.e., payments made by a Canadian financial institution ("FI") to an arm's length Canadian person that do not pertain to a U.S. trade or business. Such payments could potentially be subject to FATCA withholding, but are not subject to any such obligations under the current inter-governmental agreement ("IGA") between the U.S. and Canada. Mr. Musher explained that the enormous undertaking to introduce FATCA is being approached in a staged manner, and that foreign pass-through payments are still years away from being addressed. The main focus to date has been to provide guidance to allow foreign FIs to "gear up" to meet compliance obligations that largely begin on July 1, 2014. In aid of this, a notice released shortly prior to the IFA conference

announced that 2014 and 2015 would be transition years, and that some flexibility would be afforded with respect to the documentation of foreign entities during these years. In contrast, the FATCA regime with respect to foreign pass-through payments is scheduled to be implemented at a later stage, and will not be introduced until at least 2017. Mr. Musher acknowledged that there is a long way to go before the foreign pass-through payment provisions can be implemented, and highlighted the mutual commitment of Canada and the U.S. (found in articles 6(2) and (3) of the IGA) to explore alternatives to deal with such payments.

Mr. Musher next discussed the recently released roadmap for transfer pricing audits. He noted that the roadmap is a work in progress. It is intended to facilitate the availability of resources such as experts (including non-legal experts such as economists and intellectual property experts) to international examiners on a timely basis with the ultimate goals of resolving cases as early as possible and of better developing and framing issues in cases that do proceed to controversy. Consistency in the examination process is not a primary focus of the initiative, but Mr. Musher believes it will likely be a collateral benefit of improved case development. The role of the Office of the Chief Counsel is to assist the IRS in identifying the cases that are most significant to its international transfer pricing strategy and that warrant the sustained investment of resources.

The discussion then turned to the topic of intangibles. Mr. Musher was asked for his thoughts on whether the arm's length standard can be used to evaluate intangibles transactions that would not occur between arm's length parties, such as transfers of "crown jewel" assets. He replied that the arm's length standard was almost a categorical imperative, and would be applied even in situations where a comparative uncontrolled price is difficult to find. The key is to understand the economics of the related party deal. From a U.S. perspective, legal form and character (including legal ownership of intangibles) are secondary to the underlying economics of a transaction.