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Re: Consultation on Tax Planning by Multinational Enterprises

To Whom It May Concern:

On February 11, 2014, the Government announced its 2014 Budget, setting forth its spending priorities for the coming year, proposing numerous tax measures, and inviting comments on several important consultations. On behalf of Tax Executives Institute (TEI), I am writing to express our comments and concerns about the Government's consultation on tax planning by multinational enterprises (hereinafter "the Consultation"). These comments focus on the corporate income tax considerations.

Background on Tax Executives Institute

TEI is the preeminent international association of business tax executives. The Institute's more than 7,000 professionals manage the tax affairs of nearly 3,000 of the leading companies in North America, Europe, and Asia. Canadians constitute approximately 15 percent of TEI's membership, with our Canadian members belonging to chapters in Calgary, Montreal, Toronto, and Vancouver. TEI members must contend daily with the planning and compliance aspects of Canada's business tax laws, including its treaties. Many of our non-Canadian members (including those in Europe and Asia) work for companies with substantial activities and investments in Canada. The comments set forth in this letter reflect the views of TEI as a whole, but more particularly those of our Canadian constituency.

TEI concerns itself with important issues of tax policy and administration and is dedicated to working with government agencies to reduce the costs and burdens of tax compliance and administration to our common benefit. In furtherance of this goal, TEI supports efforts to improve the tax laws and their administration at all levels of government. We believe that the diversity, professional training, and global viewpoint of our members enable us to bring a balanced and practical perspective to the issues raised by the Consultation on tax planning by multinational enterprises.

General Comments

The Organisation for Economic Co-operation and Development (OECD) has launched a project aimed at addressing the perception that its Member States, including Canada, and other G-20 countries are losing corporate tax revenue because multinational enterprises (MNEs) engage in “base erosion and profit shifting” (BEPS) strategies. The project has resulted in the publication of a 15-step *Action Plan on Base Erosion and Profit Shifting* (hereinafter “the Action Plan”) as well as publication of numerous consultation documents pursuant to the Action Plan. The Government of Canada has initiated this consultation to “set its priorities and inform Canada’s participation” in the international discussion. Before responding to the questions posed by the Government in its 2014 Budget, TEI has several prefatory observations and comments.

First, the countries participating in the BEPS project have widely varying economic conditions, budget priorities, and tax policies. As a result, it is unlikely the Action Plan will produce a single, consistent framework and it is questionable whether the outcomes in respect of any of the Action Plan’s multiple steps will be consistently adopted or applied by all countries. Thus, contrary to the OECD’s desire to develop a consensus approach to international taxation and to curbing BEPS, TEI believes that countries will tackle the issues that are problematic in their particular jurisdiction, adopt policies that are inconsistent with others, exacerbate the current patchwork of international tax rules, and increase the risks of multiple taxation. To minimize the potential for undermining the competitiveness of Canada’s tax system, TEI recommends that Canada act on OECD BEPS recommendations only after careful consideration of the potential *impact to the Canadian economy and particular industries* and then only where consensus on a specific course of action is reached by all or substantially all OECD members (taking account of the actions of Canada’s principal trading partners and economic interests).

Next, during the last several budget announcements, the Government has undertaken targeted actions that parallel the BEPS initiatives, effectively resulting in a “Made in Canada” BEPS Action Plan. Those actions include adopting limitations on interest deductibility (through the introduction of the foreign affiliate dumping rules and the enhancement of the thin capitalization regime) and curbing hybrid mismatches through the introduction of foreign tax credit generator rules. Canada has also taken measures to counter aggressive tax planning through enhanced disclosure rules (e.g., section 237.3 of the Income Tax Act) and adopted substantive, targeted technical measures to address potential base erosion through loss trading, character conversions, offshore insurance, and synthetic disposition transactions. In addition, recent amendments to the controlled foreign affiliate rules (especially the introduction of the upstream loan rules) and the evolving anti-Treaty-shopping proposals will have far-reaching (and potentially unintended) effects. As a result, Canada is at the forefront of curbing perceived base

erosion and profit shifting. Before considering additional BEPS-related initiatives recommended by the OECD, the Government should consider the individual and combined effects of its actions to date as well as their potential interaction with the OECD initiatives.

Finally, an underlying premise of the OECD BEPS Action Plan is seemingly that all MNE international tax planning is offensive because it somehow results in tax base erosion that must be curtailed. Government data from recent fiscal years suggests, however, that is not necessarily the case in Canada. According to statistics published on the Department of Finance website, corporate income tax revenues have remained stable through the past five fiscal years, both in absolute dollars and in the proportion of government revenues collected.¹ Most recently, Budget 2014 projects total corporate income tax revenues will be \$35 billion in the coming year, which is in line with the recent trend and growth in the Canadian economy.

1) What are the impacts of international tax planning by MNEs on other participants in the Canadian economy?

TEI is not aware of any quantitative study from which an objective response to this question can be formulated. In the absence of “hard data,” it is difficult to reconcile qualitative or anecdotal perspectives to provide meaningful commentary. Having said that, business decisions are driven primarily by economic and strategic considerations and tax planning is undertaken to align those business decisions and strategies with the legal, regulatory, and tax structures of the countries where MNEs operate.

Companies must continuously adapt to changing economic and regulatory conditions of the worldwide economy, which still has many barriers to trade and investment. This trend will likely continue. Unfortunately, the inherent complexity of the global economy, and therefore MNE operations, makes it challenging for tax authorities to understand how a particular business decision fits within an MNE’s worldwide business model. Since tax authorities do not deal with complex business issues on a day-to-day basis, they are at a disadvantage when assessing the underlying reasons for a business decision. For this reason, tax authorities may assume that a decision was motivated solely or primarily by tax planning. Business decisions, however, are essentially driven by economic and strategic considerations. Tax considerations are secondary. Once a business decision is made, an MNE will consider all the tax consequences of alternative structuring proposals, including the use of favourable tax rules, regimes, and incentives that many countries (including Canada) adopt to attract and retain business investments. In many cases, these rules and regimes are a primary driver of the low effective corporate income tax rates

¹ Reported amounts are, as follows:

Fiscal Year	Corporate Income Tax Revenue	Percentage of Federal Revenue
2008-09	\$29.5 billion	14%
2009-10	\$30.4 billion	13%
2010-11	\$29.9 billion	12.6%
2011-12	\$31.7 billion	13%
2012-13	\$35 billion	14%

reported by MNEs. And yet low effective tax rates have led to much of the political pressure behind the BEPS project. Regrettably, the BEPS Report and Action Plan far too often give the impression that the sole purpose or overriding reason for MNE activity is tax planning, especially in the case of transactions between related enterprises.

Another consideration is the administrative environment in which MNEs operate. Most MNEs undergo frequent, if not continuous, examinations by multiple tax authorities, including Canada Revenue Agency (CRA). To ensure tax compliance in all jurisdictions, MNEs create, maintain, and adhere to strict documentation policies as part of their internal controls to manage tax risks and to properly report their tax liabilities. MNEs are subject to multiple levels of review, including internal audits and external audits by independent accounting firms. Finally, many companies are subject to external regulatory compliance requirements such as those imposed by the Office of the Superintendent of Financial Institutions, the U.S. Federal Reserve, provincial securities regulators, and the U.S. Securities and Exchange Commission. That administrative environment, in addition to the reputational risks that officers and directors of companies manage, act as an independent curb on multinational tax planning.

In TEI's view, the most effective means for Canada to level the playing field between the perceived advantages of MNEs over local businesses is to reduce the domestic tax burden for both by adopting the lowest possible statutory corporate income tax rates consistent with the government's revenue needs. Other incentives, such as accelerated capital cost allowance rates, will also stimulate investment in Canada, especially by smaller businesses, by reducing the net present value cost of investments.

2) Which of the international corporate income tax and sales tax issues identified in the BEPS Action Plan should be considered highest priorities for examination and potential action by the Government?

To date, Discussion Drafts have been released for public consultations for five of the fifteen BEPS Action Items. TEI has provided comments on the action items directly to the OECD and will continue to do so as additional Discussion Drafts are released.² Nonetheless, it may be premature for TEI or other commenters to give a fully informed response to this Consultation question because the scope, direction, purpose, timing of implementation, and effect of many of the recommended actions — even those that have been released in Discussion Drafts — remain unclear and subject to revision by the OECD.

Because of the dynamic environment surrounding this Consultation, TEI's views on the individual Action Items (and the BEPS project as a whole) will evolve as additional OECD Discussion Drafts are released and revised and final recommendations are issued in respect of the

² TEI's comments, including those in respect of the BEPS projects, are publicly available on the Institute's website at www.tei.org. In addition to two letters relating to the Action Plan generally, TEI has commented on Action Item 1 (Digital economy), Action 2 (Hybrid mismatch arrangements), Action 6 (Preventing treaty abuse), and Action 13 (Re-examine transfer pricing documentation, which includes the country-by-country reporting template). Also, Action 8 will address transfer pricing of intangibles and incorporate prior work by the OECD in this area. TEI has commented on the special considerations for intangibles.

Action Plan. Hence, TEI encourages the Government to (1) maintain a regular, ongoing dialogue with affected taxpayers, taxpayer groups, and practitioners and (2) be flexible and prepared to revisit its views and conclusions as the BEPS project unfolds and the recommendations for action are unveiled. In other words, we do not believe this Consultation is a “one and done” enterprise for the Government. With that background, TEI offers the following comments for consideration.

The BEPS Action Plan timeline is exceedingly ambitious in light of the scope and magnitude of the OECD’s agenda. As important, Canada already has robust rules in many areas being addressed by the BEPS Action Plan, which affords the Government time to be circumspect and selective in how it proceeds. Thus, TEI cautions against permitting the staggered consideration and release of Discussion Drafts of Action Items to dictate the outcome of individual items. Although there is clear linkage among the Action Items, the order of consideration of the separate Discussion Drafts should not determine the outcome of any one item. A considered review and reconsideration of the merits or deficiencies of the individual Action Items in the context of all the work undertaken is warranted before any government, including Canada, implements them. Indeed, as subsequent Action Items are released for discussion or implementation, earlier recommendations or decisions taken by the OECD on individual Action Items may need to be revisited. The recommendations in subsequent Action Items may well supersede or even conflict with decisions and recommendations made in respect of earlier Action Items, creating the potential for significant confusion and uncertainty for taxpayers and tax authorities, increased risk of double taxation, and significant revisions to recordkeeping requirements.³ Although TEI fully supports the Government’s participation in the OECD’s BEPS effort, implementation of any recommended actions should be measured and deliberate rather than hasty. Canadian businesses desire a healthy tax environment at home and abroad in which to compete. Making the right decisions in the context of the BEPS Action Plan is important to ensure that the objectives are met without substantially increasing taxpayer compliance burdens or increasing the risks of double taxation.

Action Items 2, 3, and 4 (hybrid mismatches, CFC rules, and interest expense), address substantial, complex technical matters, and will likely be important to Canada as the BEPS Action Plan moves toward specific recommendations. They are also potentially controversial. To address hybrid mismatches, the Government has already negotiated Article IV(7) of the Canada-U.S. Tax Treaty and adopted foreign tax credit generator rules. To a lesser extent, the character conversion and synthetic disposition rules the Government has introduced will also minimize hybrid mismatches.

To prevent base erosion through interest expense deductions, three successive rounds of Budget measures have broadened Canada’s tax base and tightened the thin capitalization rules. In addition, the foreign affiliate dumping regime will further limit interest expense deductions in Canada. We note that some of these changes were driven by the recommendations of the Advisory Panel on Canada’s System of International Taxation and, thus, reflect a “Made in Canada” approach to these issues. The Government should be wary of reversing its prior

³ For example, Action Item 13 (Re-examination of transfer pricing documentation requirements) has introduced a country-by-country reporting template with substantial recordkeeping requirements. As additional BEPS actions are completed, the information proposed in the template may diminish — or expand requiring MNEs to implement a second round (or more) of system changes.

decisions without careful consideration. For example, when the Government introduced section 18.2 several years ago, it attempted to limit base erosion by curbing interest expense deductions for outbound double dips and tower structures. Those proposed rules were eventually abandoned at the urging of taxpayers, advisers, and the recommendation of the Advisory Panel.

BEPS Action Plan Item 13 (Re-examine transfer pricing documentation) has also engendered substantial comment from the international tax community. One of the stated objectives of the Discussion Draft is to permit tax authorities to conduct more effective transfer pricing risk assessments. TEI believes that MNEs already provide a substantial amount of information to CRA through annual Form T106 reporting that permits CRA to conduct risk assessments of taxpayers' transfer pricing. In addition, Canadian taxpayers are required to maintain contemporaneous documentation to support the transfer prices for all cross-border transactions and produce such documentation on demand by the Minister. We do not believe CRA requires additional information for either risk assessment or substantiation of transfer pricing. Notwithstanding reports⁴ of subsequent reductions by the OECD in the information required to be maintained and provided, the level of detailed reporting that is being proposed in Action Item 13 would significantly increase the compliance burden and costs imposed on businesses and is far more than necessary for a risk assessment. Before adding to the already substantial reporting and documentation burdens of Canadian taxpayers, the Government should assess whether CRA needs any additional information to conduct risk assessments or evaluate the arm's length nature of taxpayer's transactions. Indeed the excessive information required by OECD Action Item 13 could swamp the CRA (and other tax authorities) with data they may not need, burden MNEs with excessive compliance costs, and impair Canadian competitiveness.

Indeed, ever increasing transfer-pricing documentation is not the answer to resolving transfer-pricing controversies. Instead, governments should take the time to understand the nature of the taxpayer's business and transactions and request more *targeted* information. Thus, the OECD's rules on transfer pricing and proposal on documentation requirements would be improved by the adoption of materiality thresholds and safe harbors, but the Discussion Draft on country-by-country documentation is largely silent about how the documentation compliance burden on businesses can be reduced or tailored to the relevant level of tax risk. One beneficial recommendation in the Discussion Draft is for tax authorities to share the transfer pricing risk assessments with taxpayers. We concur, and encourage the Government to consider that recommendation.

Finally, the increased level of commercially sensitive information being requested in the Discussion Draft on Action Item 13 (*e.g.*, including the requirement that taxpayers supply a list of the MNE's material intangibles and a description of its overall strategy for the development, ownership and exploitation of such intangibles) should be of concern to the Government. Canada's data and intellectual property protection laws are far more robust than those in many other countries. If adopted, the Discussion Draft would substantially increase the risk of

⁴ See *Revised Transfer Pricing Discussion Draft Kept Under Wraps*, 2014 Worldwide Tax Daily 103-1 (May 29, 2014); 74 Tax Notes Int'l 779 (June 2, 2014). See also slide 26 of the PowerPoint materials used during the OECD's April 2, 2014, webcast *Update on BEPS Project* available at <http://www.oecd.org/ctp/OECD-BEPS-Webcast-2April.pdf>.

disclosure of highly sensitive and confidential taxpayer information. To minimize the risk of disclosure, TEI believes that an MNE should only be required to provide sensitive information to the tax authorities in the MNE's home country, and such information should only be shared with other tax authorities pursuant to exchange of information agreements where adequate safeguards for protection of the data are in place.

3) Are there other corporate income tax or sales tax issues related to improving international tax integrity that should be of concern to the Government?

Yes, TEI believes there are certain issues with respect to targeted tax incentives and tax administration that should be of concern to the Government.

Countries are free to implement tax incentives to attract and retain foreign direct investment or other activities as they see fit and business should be allowed, and encouraged, to use legitimate and transparent tax incentives that promote purposeful economic activity. To the extent that the Government wishes to implement specific and limited tax incentives to increase or maintain Canada's competitiveness and attract foreign investment, it should review the experiences of other countries to understand what has worked well and where improvements could be made. It is important that any such initiatives result not only in a more competitive tax system, but also a more administrable system. Excessively complex incentives — or incentives burdened with excessive documentation or administrative requirements — will undermine the Government's objectives and may result in a disproportionate share of the benefits being offset by administrative costs, including fees paid to external tax advisors.

TEI also believes that the Government should consider measures to improve the efficiency of tax administration through, for example, ensuring the retention of knowledgeable senior CRA officials and investing in the training and development of all audit staff with respect to BEPS-related matters. In addition, CRA should be encouraged to pursue and expand the use of cooperative compliance models⁵ and other streamlined approaches to audit protocols, especially with respect to transfer pricing risk assessment and transfer pricing documentation requirements for low-risk taxpayers, low-risk transactions, or other entities or transactions for which scrutiny can be reduced through the adoption of a materiality threshold.

4) What considerations should guide the Government in determining the appropriate approach in responding to the issues identified – either in general or with respect to particular issues?

In its 2008 *Final Report*,⁶ the Advisory Panel outlined six guiding principles⁷ that Canadian tax policy makers should abide by in structuring Canada's international tax policy. The

⁵ For example, the U.S. Internal Revenue Service has adopted a Compliance Assurance Process that provides for a real time examination of large taxpayers that demonstrate robust compliance processes and a commitment to transparency in respect of tax risks. Similarly, the United Kingdom and the Netherlands have horizontal monitoring processes.

⁶ *Enhancing Canada's International Tax Advantage*, Advisory Panel on Canada's System of International Taxation (December 2008).

Advisory Panel acknowledged that setting international tax policy involves trade-offs and practical constraints. TEI agrees with those principles and recommends that any actions the Government wishes to adopt from the BEPS Action Plan be evaluated in the context of those principles.

In addition, TEI recommends that the Government consider the following additional factors and constraints while participating in the BEPS discussions or when evaluating implementation of proposals in Canada:

- i) *Consistency and speed of adoption* – Recommended OECD actions should be acted upon when a coordinated global approach on specific measures is agreed to and can be implemented on a consensus basis.
- ii) *Cost of compliance* – Taxpayers do not have unlimited resources for compliance efforts; compliance burdens and documentation requirements should be proportional to the revenue effects.
- iii) *Economic impact* – A thorough study of macroeconomic effects of the OECD proposals — singularly and in combination with others — should be undertaken. The overall effect on the economy and Canadian businesses should be assessed rather than limiting the forecast to revenue effects.
- iv) *Consideration of effects on specific industries* – Consideration should be given to the potential effect of proposals upon different industries.
- v) *Transitional rules* – The Government should ensure that appropriate legislative and administrative transitional rules and, where applicable, grandfathering provisions, are adopted.

For taxpayers, a coherent and consistent set of rules that provide clarity, predictability, and certainty of application is critical. While a simple set of rules may not be feasible given the complexity of the global economy and the myriad of industries and taxpayer participants in the

⁷ The *Final Report*, at page 11, states, as follows:

- Canada's international tax system for Canadian business investment abroad should be competitive when compared with the tax systems of our major trading partners.
- Canada's international tax system should seek to treat foreign investors in a way that is similar to domestic investors, while ensuring that Canadian-source income is properly measured and taxed.
- Canada's international tax system should include appropriate safeguards to protect the Canadian tax base.
- Canada's international tax rules should be straightforward to understand, comply with, administer and enforce, to the benefit of both taxpayers and the CRA.
- Full consultation should precede any significant change to Canada's international tax system.
- Canada's international tax system should be benchmarked regularly against the tax systems of our major trading partners.

economy, the design of the international tax rules should, where possible, be *simplified*. The more complex and onerous the requirements are for businesses to comply with and governments to administer, the less likely the Action Items will be adopted broadly and consistently, thereby creating multiple standards with the attendant risk of double taxation for businesses and perhaps double non-taxation for governments.

Another important facet is ease of compliance and administration. To that end, and to the extent that the Government chooses to adopt any recommendations flowing from the BEPS Action Plan, TEI recommends that the Government consider a phased roll out of the specific measures wherever possible. Finally, TEI believes that it is important to build in flexibility wherever possible to afford taxpayers the best means to choose to comply with the requirements of local law. For example, taxpayers should be permitted to choose the best source from among multiple data sources to satisfy transfer pricing documentation and country-by-country requirements.

The Government states in the Consultation that it “is interested in obtaining views on how to ensure fairness among different categories of taxpayers (e.g., MNEs, small businesses and individuals).” Ensuring fairness across different categories of taxpayers is a challenging and perhaps impossible task since fairness — like beauty — often lies in the eye of the beholder. If fairness means that similar transactions or similarly situated taxpayers are taxed similarly, most taxpayers would agree with the concept. But in many cases, policy or political reasons dictate that taxpayers are not treated identically. (For example, special Notice of Objection Rules apply to large taxpayers.) Rather than attempting to ensure fairness across different categories of taxpayers, TEI recommends that the Government continue to develop tax policies that protect the Canadian tax base through a broad base with low rates, while promoting favourable conditions for Canadian businesses to succeed at home and abroad.

5) Would concerns around maintaining Canada’s competitive tax system be alleviated by coordinated multilateral implementation of base protection measures?

In general, yes. TEI believes that it is critical to coordinate not only among countries in respect of the individual Action Items, but also to ensure that the individual BEPS recommendations are coordinated with one another. In other words, recommendations relating to, for example, hybrid mismatches should be coordinated with interest deductibility and Canada’s CFC rules. That said, achieving a coordinated multilateral implementation of base protection measures might be difficult since countries have differing economic conditions and sovereign interests. When developing — or protecting — the tax base and setting differing rates of income, sales and withholding taxes, countries may well take account of other budget and non-tax considerations, such as home-country industries, employment conditions, and the degree of private vs public ownership of business enterprises. As noted, Canada is in a favourable position because it has already addressed many BEPS-related items through a “Made in Canada” approach. Accordingly, TEI recommends that the Government refrain from taking immediate or unilateral actions in respect of BEPS and instead consider a deliberate and measured implementation approach taking account of the effect on Canada’s competitiveness and the actions of Canada’s principal trading partners.

Conclusion

TEI's comments were prepared under the aegis of its Canadian Income Tax Committee, whose chair is Bonnie Dawe of Finning Corporation. Should you have any questions about TEI's comments, please feel free to contact Ms. Dawe at 604.331.4864 (or bonnie.dawe@finning.com) or Shiraz J. Nazerali, TEI's Vice President for Canadian Affairs, at 403.213.8125 (or shiraz.nazerali@dvn.com). TEI is pleased to acknowledge consent to publish these comments on the Department of Finance's website.

Respectfully submitted,

Tax Executives Institute, Inc.

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