Tax memo

Canadian tax updates

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TCDR alert: Competent authority – Protect your rights

Outlines issues taxpayers should consider when requesting relief from double taxation, other than in respect of the United States.

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Canada currently has 89 income tax treaties in force, each of which includes a provision for the relief of double taxation under the Mutual Agreement Procedure (MAP) article. However, each country retains the right to its own interpretation of its treaties, so some countries, such as Brazil and Argentina, do not have very active MAP programs with Canada.

Specific wording in the Canada-U.S. treaty allows the treaty to override domestic legislation. As a result, when a taxpayer makes a request to either competent authority for relief from double taxation, any settlement between the Canadian and United States competent authorities can be applied to the tax returns of the respective taxpayers, regardless of whether the taxation year subject to double taxation is statute-barred domestically. This applies provided the competent authority of the non-initiating state is notified of a potential request for competent authority assistance within six years from the end of the applicable taxation year.

Because the vast majority of double taxation cases handled by the Canadian competent authority are brought under the Canada-U.S. treaty, taxpayers have become complacent, believing that all Canadian treaties are similar to this one. Not so.

The remainder of this *Tax memo* addresses issues that Canadian taxpayers must be aware of under two scenarios, when requesting relief from double taxation other than in respect of the United States.

Canadian-initiated adjustments

Canadian-initiated transfer pricing adjustments are those raised by the Canada Revenue Agency (CRA). In this regard, taxpayers must be aware of three areas of the *Income Tax Act* (the Act):

- The Act provides that, in respect of a transaction with a non-resident related party, the taxation year of the Canadian taxpayer does not become statute-barred for a period of seven years from the date of the Notice of Assessment.
- A waiver can be filed in respect of such transactions at any time during this seven-year period to extend the statute-barred date for a given taxation year.
- Once a Notice of Objection is filed in regard to a transfer pricing adjustment, the Appeals Directorate can process an adjustment pertaining to the issue beyond the seven-year statute-barred period without the necessity of the taxpayer filing a waiver.

With every proposal letter from the CRA pertaining to a transfer pricing adjustment, to avoid Part XIII non-resident tax being assessed as a deemed dividend, a taxpayer is given the option to "repatriate" the amount of the proposed adjustment. While this may seem an attractive option, especially when the withholding rate is high, the CRA requires that the taxpayer waive its right to file a Notice of Objection as a condition of exercising this option. Without the ability to file a Notice of Objection, taxpayers must file a waiver to prevent the tax year from becoming statute-barred, to ensure that any settlement reached by the competent authorities can be processed domestically.

Our experience has been that most transfer pricing reassessments by the CRA apply to taxation years that are within a couple of years of becoming statute-barred. Taking into consideration the time to prepare and file a competent authority submission and that it may take more than two years to reach a settlement with the foreign competent authority, it is not uncommon that the seven-year statute-barred period has elapsed by the time the CRA considers reassessing the taxpayer to reflect the competent authority settlement. If the taxation year is not kept open, the taxpayer will not benefit from the competent authority settlement.

As a result, Canadian taxpayers should be aware that when the CRA reassesses transactions with non-resident related parties located in jurisdictions other than the United States, they must file either a waiver for the applicable taxation year or a Notice of Objection to ensure that any settlement reached through the competent authority process can be made in the event the taxation year becomes statute-barred under the Act.

Foreign-initiated adjustments

Transfer pricing adjustments raised by a foreign jurisdiction pertaining to transactions with a Canadian taxpayer are treated differently.

Many of Canada's treaties indicate that a transfer pricing adjustment must be made within a specified number of years (usually five to seven years from the end of the fiscal year) regardless of domestic legislation in each country. In the absence of the treaty setting out a specified time frame for reassessment, domestic legislation prevails.

Many foreign countries will provide relief from double taxation regardless of the duration of the competent authority process, if any reassessment is made within the period covered by a treaty and the subsequent request for competent authority is made within the period set out in the treaty. Canada does not share this point of view and will not process a competent authority settlement if the taxation year of the Canadian taxpayer is statute-barred.

More often than not, Canadian taxpayers are not aware of audits in foreign jurisdictions that involve transactions with Canada. However, this lack of awareness does not preclude taxpayers from ensuring that the relevant years in Canada are not statute-barred by filing the necessary waivers.

Consequently, communications within a multinational group are crucial when it comes to transfer pricing audits. Awareness of foreign audits that involve transactions with Canada is necessary so that appropriate steps can be taken to ensure that when there is a reassessment and a subsequent request to the competent authorities to relieve double taxation, the Canadian tax returns can be reassessed to reflect that settlement.

Need more help?

For more information, please contact any of the following members of our Tax Controversy and Dispute Resolution (TCDR) network:[1]

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