

Updated Canadian administrative guidance on competent authority assistance

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Author: [Ilana Ludwin](#)

The Canada Revenue Agency (CRA) released its first update in 16 years to its administrative guidance on seeking assistance from the Canadian competent authority under Canada's tax conventions. Information Circular 71-17R6 ("New Circular") was released on June 1, 2021,^[1] replacing the prior IC71-17R5 dated January 1, 2005 ("Old Circular"). The update reflects many international tax developments that have occurred since the last update to the Circular, most notably the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("MLI") and the 2007 amendments to the Canada-U.S. Tax Treaty. There are also numerous changes to the administrative procedure followed by the CRA in respect of requests for competent authority assistance, most of them in respect of assistance under the Mutual Agreement Procedure (MAP) article in Canada's tax conventions. The most significant changes in the New Circular concern:

- The MLI;
- Arbitration;
- Changes to the process for requesting assistance;
- MAP timeline targets; and
- Issues specific to the Canada-U.S. Tax Treaty.

Shortly after the New Circular was released, the CRA also released its first update to TPM-02R, the CRA memorandum regarding secondary transfer pricing adjustments, repatriation, and non-resident withholding tax under Part XIII ("TP Memo"). The original TP Memo was released more than 18 years ago. The revised TP Memo aligns with changes to the New Circular in respect of these same topics and greatly expands on the prior guidance, most significantly reflecting domestic legislative amendments enacted in 2012.

MLI

A new section of the New Circular describes the MLI and confirms its application in Canada. The section is brief, describing the goal of the MLI as being to "modify existing tax treaties in a coordinated manner in order to swiftly implement treaty-related measures developed during the BEPS project" (para. 119).^[2] Two specific types of MLI measures are mentioned: anti-abuse provisions and new dispute resolution mechanisms. The New Circular does not otherwise substantively discuss or explicitly reflect changes resulting from the MLI that would affect the competent authority process. The New Circular mentions that the Canadian competent authority may negotiate MAPs involving treaty anti-avoidance rules with their treaty partners for purposes of reaching a consensus on their application (para. 44). This possibility of negotiation contrasts with the CRA's refusal to negotiate cases involving domestic anti-avoidance provisions (para. 43). This new position applies to anti-avoidance

rules in all treaties and is not specific to the MLI. Similarly, no guidance is provided in respect of binding arbitration under the MLI other than noting that it currently applies or is expected to apply to 21 of Canada's tax treaties (para. 120). Instead, as discussed in the next section, only arbitration under the existing Canada-U.S. Tax Treaty is addressed.

The Old Circular referred to the Pacific Association of Tax Administrators (PATA) and noted that PATA's "Operational Guidance on the Mutual Agreement Procedure" was "a useful summary of the operational guidance principles to which Canada adheres" (para. 8). All references to PATA have been deleted in the New Circular. As such, taxpayers should no longer look to PATA guidance in respect of MAPs.

PATA remains relevant in the context of preparing contemporaneous documentation for controlled transactions. The CRA confirms in a separate publication that compliance with the PATA Transfer Pricing Documentation Package will satisfy the documentation requirements in all PATA member states (Australia, Canada, Japan, United States). Although such compliance is voluntary, adherence may protect taxpayers from transfer pricing penalties.^[3]

Arbitration

A new section specific to the Canada-U.S. Tax Treaty sets out the basic process for binding arbitration under Article XXVI(6) (paras. 91–94). Binding arbitration was added to the treaty in 2007 through the 5th protocol of the Treaty. The Old Circular, which was released prior to the 5th protocol, did not mention arbitration in any context (though optional arbitration was available prior to the 5th protocol).

The New Circular sets out the procedure for Article XXVI(6) binding arbitration: that it is available for both MAPs and "MAP cases involving an APA [advance pricing arrangement]"; that there must be tax returns filed in at least one of Canada or the United States to be eligible; that arbitration generally begins two years after a MAP begins; and that arbitration is not available for all of the Canada-U.S. Tax Treaty articles (or the competent authorities might otherwise determine that a MAP is not suitable for arbitration) (para. 91).

No further details or analysis are provided. Instead, taxpayers are directed to consult Annex A of the 5th protocol and the Memorandum of Understanding Between The Competent Authorities of Canada and The United States of America ("U.S. MOU"). The New Circular does note that, in accordance with clause 3.1.1 of the U.S. MOU, if a taxpayer reaches an Appeals settlement with the CRA, any MAP they initiate will not qualify for arbitration (para. 54).

Given that the guidance provided in the New Circular is specific to the Canada-U.S. Tax Treaty, including the U.S. MOU, it should not be relied upon for arbitration under the MLI. Canada has not yet released any other guidance in this respect. We expect that such guidance will be released at a later date, potentially after the relevant signatories reach further consensus on the process.

Changes to the process for requesting assistance

There are numerous changes made throughout the New Circular on a variety of topics.

The most significant change is that taxpayers must now submit a complete request, instead of just a notification, within the required time limit where one is specified in a treaty. A request relating to a Canadian-initiated adjustment will only be considered complete once the adjustment has been implemented by way of a reassessment (para. 16). Previously,

taxpayers could comply with the time limit requirements by submitting a “notification,” which only needed to briefly set out the nature of the request, the entities, and the relevant years (Old Circular, paras. 16–18). It was also possible to submit such notifications prior to the reassessing action. Taxpayers should be mindful of this change from notifications to full requests, and the requirement that such requests be made only after a re-assessment is issued (for Canadian-initiated cases), as in many cases there will not be much time to request competent authority assistance. They may wish to submit their requests well ahead of the applicable time limit to leave enough time to cure any defects if the Canadian competent authority determines the request was not complete. The CRA, for its part, should ensure that audits are completed in reasonable time to allow taxpayers sufficient opportunity to request assistance.

It remains to be seen how the Canadian competent authority will deal with notifications filed prior to the release of the New Circular that complied with the Old Circular but may not be considered complete requests under the New Circular. It will also be interesting to see whether this new requirement will be the subject of challenge by Canadian taxpayers, as well as the view of Canada’s treaty partners on this issue.

In contrast, the “notification” procedure remains in place for purposes of Articles XXVI and IX of the Canada-U.S. Tax Treaty (paras. 79–85). The notification must be made in writing within six years of the relevant taxation year and must include “sufficient information to apprise the Contracting State of the nature of the adjustment,” namely the relevant entities (including their tax identifiers and contact information), the nature of the adjustment or issue, the applicable years, and the amounts at issue (paras. 80–82).

Both parties — the Canadian resident and its related party in a treaty country — must now submit requests for assistance from their respective competent authorities (para. 10). However, one party may file requests on behalf of both parties if authorized to do so and if the requests satisfy the requirements of the respective jurisdictions. The Canadian competent authority will not take action on a file until it receives a complete request. If a request is timely filed only in the other jurisdiction but otherwise meets the requirements of the applicable MAP article, the Canadian competent authority will consider the related late-filed request by the Canadian taxpayer to have been filed in time (para. 10). The requirement that the foreign-filed request meet the requirements of the applicable MAP article means this possibility is unlikely to be of significant assistance to taxpayers.

The request must now address, for transfer pricing MAPs, whether there are any Part XIII withholding tax implications to either the primary adjustment or any secondary adjustment (para. 17). However, taxpayers no longer need to provide their view of the possible basis for how the competent authorities might resolve the MAP, as was previously required in the Old Circular. Taxpayers can of course include their view, but the extent to which the Canadian competent authority will consider it is unknown. Whereas the Old Circular allowed taxpayers to ask the Canadian competent authority to provide the basis of its decision so that they may determine whether it was made in a “principled, fair and objective manner” (para. 7), the New Circular removes this possibility, and instead reiterates the statement from the Old Circular that “The Canadian competent authority negotiates with other competent authorities in a principled, fair and objective manner” (para. 7). Taxpayers seeking to understand the basis of Canadian competent authority decisions may have to submit an access to information request, although such requests may produce limited information due to various exemptions in the relevant statute that allow the Canadian federal government to refuse to release documents.^[4]

With the complexities of transfer pricing issues often affecting more than just two jurisdictions, multilateral resolution of issues is an important goal for taxpayers. The New Circular confirms that a multilateral MAP is possible if a taxpayer requests a multilateral

process in all of the relevant countries. Taxpayers must additionally authorize all of the involved competent authorities to exchange information. At that point, the Canadian competent authority “will explore the possibility” of pursuing a multilateral MAP (para. 13). Although this falls short of providing any certainty to taxpayers, it is at least some recognition of the importance of the issue.

The New Circular states that the Canadian competent authority will accept a case seeking a downward adjustment if the other tax authority has already accepted the request for an upward adjustment, and the other competent authority is actively working on resolving the MAP, including by providing the Canadian competent authority with its position paper (para. 27). The request must also be made within the relevant time limit and cannot concern an issue that the Canadian competent authority has decided not to address as a matter of policy — two criteria already imposed on all requests for assistance in both the New Circular (para. 23) and the Old Circular (para. 24). Moreover, taxpayers may submit downward adjustment requests in situations involving non-treaty countries. In this regard, the New Circular directs taxpayers to consult TPM-03, a transfer pricing memorandum that is no longer published on the CRA website.

Two issues — notional expenses in Canada to reflect notional income taxed in another country, and thin capitalization — are still ineligible for Canadian competent authority assistance in the form of negotiations (para. 25). However, in a change from the Old Circular, the Canadian competent authority now says it will provide an explanation to the other competent authority. The New Circular also removes a third ineligible issue concerning U.S. limited liability companies (LLCs), which are now addressed separately due to the rules in respect of hybrid entities in the 5th protocol of the Canada-U.S. Tax Treaty.

Interestingly, although the New Circular acknowledges that taxpayers that have reached an audit settlement with the CRA can seek competent authority assistance in respect of any remaining double taxation, it also notes that the CRA can take the taxpayer’s intention to seek relief into account in deciding whether to enter into the settlement (para. 73).

One helpful change is that if a taxpayer objects to or appeals a Canadian reassessment and does not hold that objection or appeal in abeyance, any competent authority process will be suspended until such time as the Appeals or court process has concluded with an outcome that, in the taxpayer’s view, is not in accordance with the relevant treaty (para. 49). Under the Old Circular, the competent authority process would have been terminated rather than suspended.

Another positive development is the CRA’s confirmation that the MAP process is not impacted by any outstanding collections issues. The New Circular notes that the Canadian competent authority is independent from the CRA’s Collections Division, and that although a taxpayer’s liability for collections will continue regardless of whether they have requested competent authority assistance, failure to comply with the CRA’s collections policies will not impact the acceptance or treatment of a MAP case by the Canadian competent authority (para. 57).

Less helpful is the CRA’s position on interest relief. Domestic interest relief in Canada is discretionary. The Old Circular said the CRA would consider waiving or cancelling a portion of regular interest (i.e., excluding interest on penalties) that accrued while a competent authority request was outstanding on a case-by-case basis, taking into account the taxpayer’s cooperation and reciprocity with the other country, on the basis that the taxpayer had no control over the process (para. 52). The New Circular only mentions the possibility of interest relief but states that the Canadian competent authority does not administer such relief (para. 64).

Map timeline targets

The New Circular establishes targets for the Canadian competent authority to complete certain stages of a MAP. For Canadian-initiated adjustments, the Canadian competent authority is now expected to provide its position paper to the other competent authority within six months of receiving all necessary information. The Canadian competent authority's target for completing the entire process for both Canadian- and foreign-initiated adjustments is 24 months after receiving all necessary information. These timelines are comfortably within the average timelines realized by the Canadian competent authority in the last several years. According to the 2019 MAP program report released in March 2021, the average time to complete the 60 negotiable MAPs that were concluded in 2019 was 17.6 months.^[5] Two-thirds of those MAPs resulted in full relief from double taxation. Interestingly, Canadian-initiated cases took an average of 16.1 months to complete, while foreign-initiated cases, which represented 20% of the 60 negotiable MAPs concluded in 2019, took 23.5 months—almost 50% longer. The 2019 MAP program report did not provide the range of times it took to complete the 60 negotiable MAPs, so it is unknown how many of these would have surpassed the 24-month target.

Issues specific to the Canada-U.S. Tax Treaty

The guidance specific to the Canada-U.S. Tax Treaty is noticeably more detailed than all other sections of the New Circular. This specificity is understandable given that the United States is Canada's most important trading partner and, accordingly, the Canadian competent authority has the most experience dealing with MAPs with the U.S. competent authority. Much of the updated guidance relates to changes implemented in the 5th protocol of the Treaty, including the addition of binding arbitration (as discussed above) and the treatment of LLCs.

Before the 5th protocol, the Canadian competent authority would not consider issues involving LLCs on the basis that they were not residents under the treaty and therefore were not entitled to treaty benefits. Article IV(6) of the Canada-U.S. Tax Treaty, which was added by the 5th protocol, extends treaty benefits to persons otherwise resident under the treaty who derive income, profit or gain through a fiscally transparent entities such as an LLC (as long as the tax treatment in the persons' hands of the amount in dispute is the same it would have been had it been derived directly). In other words, the New Circular confirms that LLC members are eligible to seek competent authority assistance (paras. 88–89).

The guidance in respect of deferred recognition of income, profit or gain under Article XIII(8) has been expanded, including the eligibility criteria for obtaining relief from timing mismatches and triggering events that will end the deferred recognition (paras. 100, 105). One new eligibility criteria is that the taxpayer is not seeking MAP for purposes of obtaining certainty regarding the Canadian tax consequences of their transactions where such certainty could be obtained through domestic measures such as advance income tax rulings. The New Circular notes that the guidance in respect of deferrals under the Canada-U.S. Tax Treaty applies to similar provisions found in other treaties (para. 98).

New appendices I and II of the New Circular set out the information required for requests under Article XXIX(5) and XXIX-B(5) of the Canada-U.S. Treaty in respect of U.S. S corporations and deferral of Canadian tax at death in some circumstances (generally, spousal rollovers).

Secondary transfer pricing adjustments, repatriation, and Part 8 withholding tax

As noted above, the New Circular now requires MAP requests to explain whether there are any Part XIII tax implications (para. 17). Although Part XIII tax and repatriation was previously addressed in the Old Circular, the New Circular adds a reference to TPM-02, the TP Memo (para. 69). The TP Memo was significantly revised and expanded, roughly tripling in length, in an update released nine days after the New Circular.

Generally, the revised TP Memo imposes stricter requirements on taxpayers that narrow the circumstances under which relief from Part XIII withholding tax may be granted. Relief, which is discretionary, is not available where the CRA's Transfer Pricing Review Committee has approved a transfer pricing adjustment under the "recharacterization" rules (generally, applicable to transactions that no arm's-length parties would have entered into); the CRA's general anti-avoidance rule (GAAR) committee has approved the application of the GAAR; other anti-avoidance provisions apply; or the taxpayer did not satisfy its obligations under a requirement or compliance order to produce information or documents during an audit.

More helpful is the TP Memo's acknowledgement that the 25% Part XIII withholding rate can be reduced under a treaty where applicable.^[6]

Conclusion

The New Circular represents an important update to the competent authority process in Canada. In addition to important procedural changes, the influence of high-level policy changes and international developments such as the MLI can be seen even in a document that is largely practical. All taxpayers with business in Canada should review the New Circular with care if they anticipate being subject to reassessing action that will require them to seek competent authority assistance.

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[1] CRA, Competent Authority Assistance under Canada's Tax Conventions, last modified on June 1, 2021.

[2] See also para. 118, which sets out a definition of BEPS that is largely similar to that used by the OECD.

[3] See CRA, Pacific Association of Tax Administrators (PATA) Transfer Pricing Documentation Package, last modified on April 14, 2021 (although no substantive changes were made compared to the version published on February 23, 2016, the recent modification date suggests the CRA recently reviewed and confirmed that this publication remains relevant).

[4] See, e.g., Access to Information Act, RSC 1985, c A-1, ss 18 and 21.

[5] See CRA, Mutual Agreement Procedure — Program Report — 2019, last modified on March 8, 2021.

[6] For more details on the TP Memo, see Kaitlin Gray, *TPM-02R: Transfer-Pricing Secondary Adjustments and Repatriation*, 11:3 Can. Tax Focus (Aug. 2021).