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Tax Information Exchange Agreements – Impact on International Tax Planning

OBA Tax Section Seminar

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Three Parts to the Discussion



- A. What is a TIEA?
- B. Context and Purpose of TIEAs
- C. Tax Implications for Canadians

What is a TIEA?



- A bilateral agreement to provide assistance in tax matters through exchange of information that will assist the two countries in administering, enforcing and collecting their respective taxes
- Canada has signed but not yet enacted a TIEA with the Netherlands Antilles, and has announced commencement of negotiations with 14 other jurisdictions, including Bahamas, Bermuda, Cayman and Jersey

What is a TIEA? (*continued*)



- Article 1 entitled “Object and Scope of the Agreement” of TIEA between Canada and Netherlands Antilles provides that such information shall include information that is *foreseeably relevant* to the determination, assessment and collection of such taxes, the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters

What is a TIEA? (*continued*)



- Article 1 requires the two countries to treat the information as *confidential*
- Article 1 also provides that the *rights and safeguards* secured to persons by the laws or administrative practice of the Requested Party remain applicable to the extent they do not *unduly prevent or delay* effective exchange of information

What is a TIEA? (*continued*)



- Article 5 entitled, “Exchange of Information on Request”, provides the code of conduct for making a request
- The Applicant Party must disclose
 - The name of the person under examination or investigation
 - Statement as to information being sought
 - Tax purpose for which information is sought
 - Grounds for believing information is in the territory of Requested Party or is in possession or control of person therein

What is a TIEA? (*continued*)



- The Applicant Party must also disclose
 - To the extent known, the name/address of any person in possession of the requested information
 - A statement that the requested information conforms to the Agreement and to the law and administrative practices of the Applicant Party's jurisdiction, and if present there, it could have been obtained under such laws and practices

What is a TIEA? (*continued*)



- The Applicant Party must also disclose
 - A statement that the Applicant Party has pursued all means to obtain the information in its territory, except those means that would give rise to disproportionate difficulties

What is a TIEA? (*continued*)



- Article 5 also obligates each party to ensure that its competent authority has the authority to obtain and provide requested information, including bank account information, beneficial ownership of corporations in an ownership chain, trust and foundation contributors, fiduciaries and beneficiaries

What is a TIEA? (*continued*)



- Article 5 requires that information received under this Agreement be treated as confidential and may only be disclosed to persons or governmental authorities concerned with tax administration in the Applicant Party's jurisdiction

Context and Purpose of TIEAs



- In April 2002, OECD released Model Treaty On Exchange of Information on Tax Matters
- In March 2007 Budget, Federal Government announced plan to negotiate TIEAs through what some call a “carrot” and “stick” approach

Context and Purpose of TIEAs (continued)



- “Carrot” means tax haven TIEA country becomes “designated treaty country” for purposes of earning “exempt surplus”

Context and Purpose of TIEAs (continued)



- “Stick” means active business income earned by a foreign affiliate in tax haven that refuses TIEA with Canada after 5 years will give rise to FAPI in the hands of controlling Canadian shareholder

Context and Purpose of TIEAs (continued)



- OECD has been working on combating offshore tax evasion since 1996, including ground-breaking report in 1998 entitled, “Harmful Tax Competition: An Emerging Global Issue”
- Purpose: to eliminate preferential regimes within the OECD members, to identify tax havens and seek their commitment to principles of transparency and information exchange

Context and Purpose of TIEAs (continued)



- A subsequent report in 2000 identified certain uncooperative tax havens and suggested measures such as disallowing deductions, exemptions, credits or other allowances related to transactions with the havens, and denying the foreign tax credit or the participation exemption regarding distributions from them
- The threat of economic sanctions and international ostracism by OECD member countries was also suggested

Context and Purpose of TIEAs (continued)



Context and Purpose of TIEAs (continued)



Context and Purpose of TIEAs (continued)



- OECD's Global Forum in October 2008 comprising 84 countries, non-OECD as well as OECD members, pledged commitment to implement OECD standard on transparency and information exchange in tax matters, requiring the following:
 - Exchange of information on request where it is “foreseeably relevant” to administration and enforcement of tax laws
 - No restrictions on exchange caused by bank secrecy
 - Availability of reliable information and powers to obtain it
 - Respect for taxpayer's rights
 - Strict confidentiality of information exchanged

Tax Implications for Canadians: Exporting Affiliate Structure



Tax Implications for Canadians: Exporting Affiliate Structure (continued)



- Will the Canadian Entrepreneur move the IBC to a TIEA country, like Bahamas, where there is zero taxation?
- Tax and non-tax considerations must be taken into account

Tax Implications for Canadians: Exporting Affiliate Structure (continued)



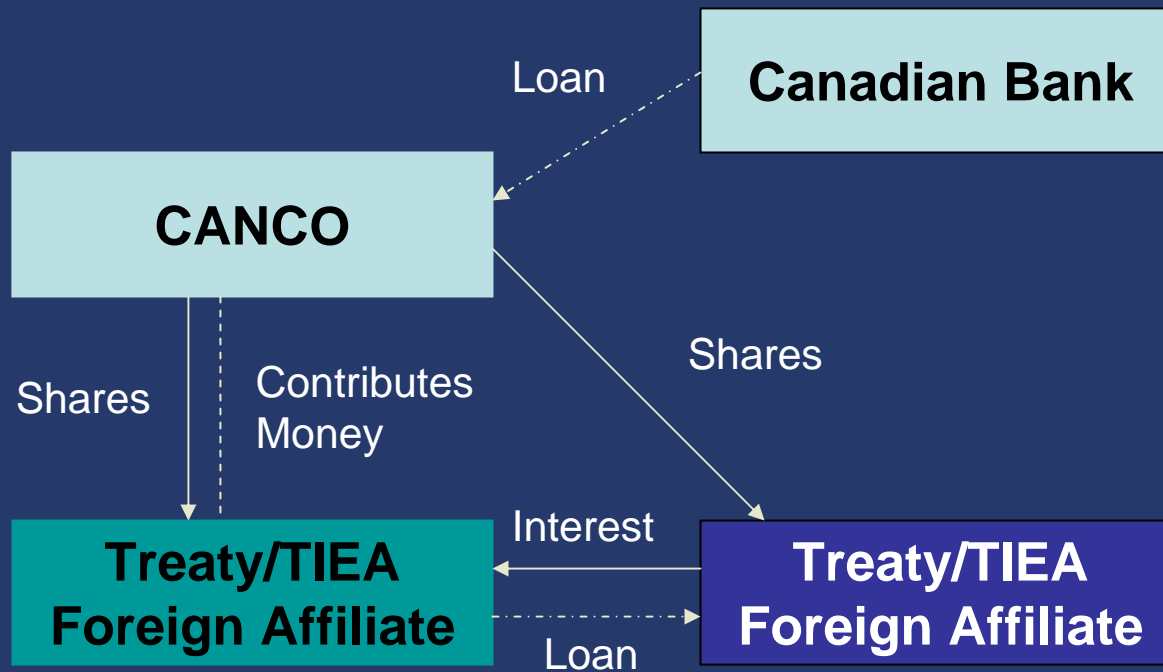
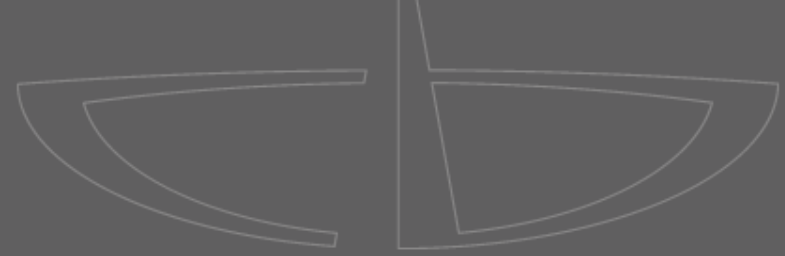
- Barbados has a network of 18 tax treaties and 9 Bilateral Investment Treaties. Generally, tax havens have neither
- Must consider:
 - Local service providers
 - Professional legal, accounting and banking services
 - Legal and regulatory systems and ability to enforce rights
 - Foreign exchange controls
 - Ease of access/communication/transportation/time zones
 - Political stability & lack of corruption

Tax Implications for Canadians: Exporting Affiliate Structure (continued)



- Arguably the extension of “exempt surplus” treatment to TIEA countries can be seen as a move to de-link such treatment from tax treaties and could even be taken further
- According to December 2008 Report of Advisory Panel on Canada’s System of International Taxation, “exempt surplus” treatment should be extended to all active business income earned by a foreign affiliate in whatever jurisdiction it operates

Tax Implications for Canadians: Double-Dip Structure

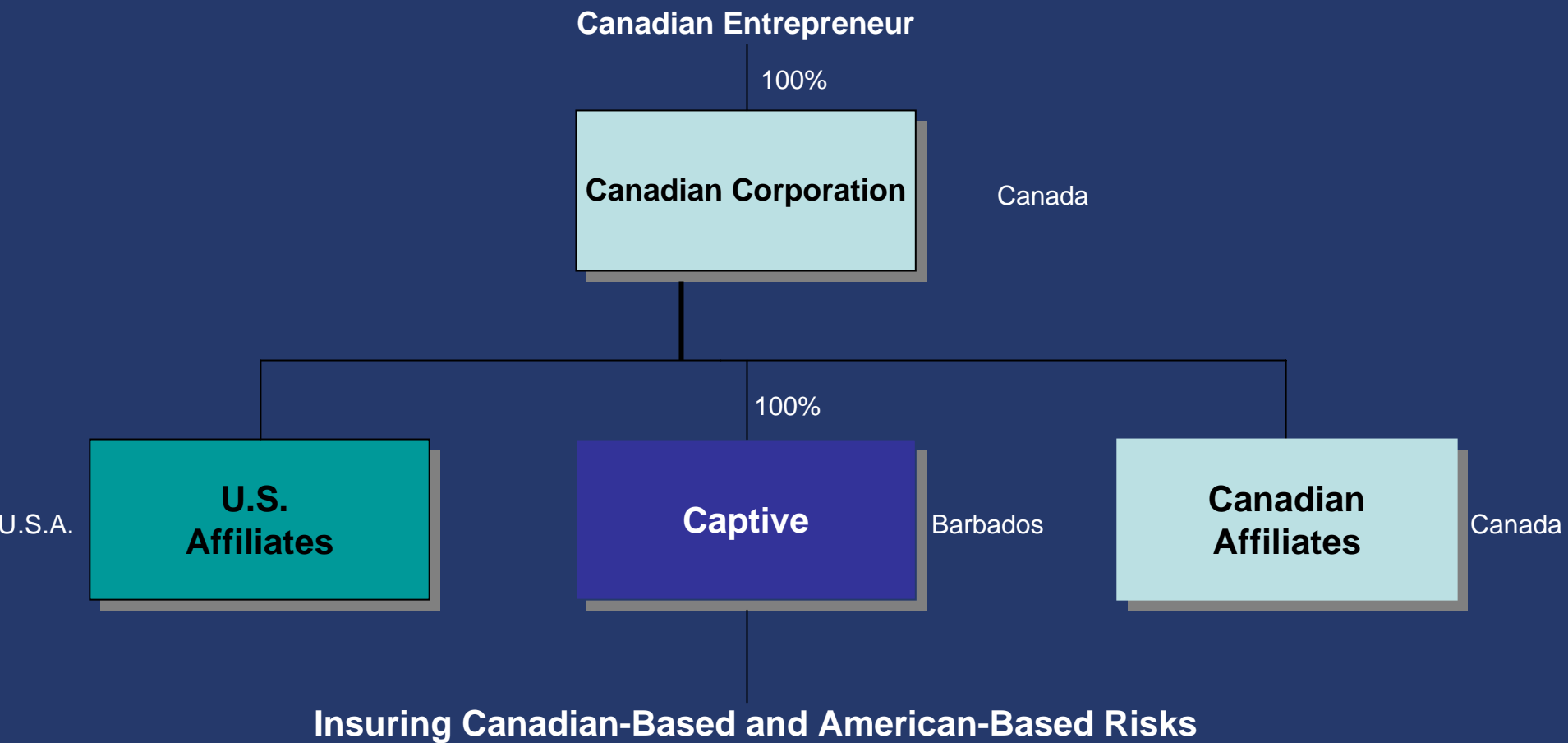


Tax Implications for Canadians: Double-Dip Structure (*continued*)



- Canco obtains interest deduction in Canada
- Interest received by Tax Treaty/TIEA FA may be considered to be “double-dip income”
- With repeal of s.18.2 that would have denied the Canadian interest deduction, the extension of paragraph 95(2)(a) deemed active business income to tax haven TIEA countries seems perversely to contradict the March 2007 Budget in which s.18.2 was introduced as part of an attack on Canadian’s use of tax havens

Tax Implications for Canadians: Captive Insurer

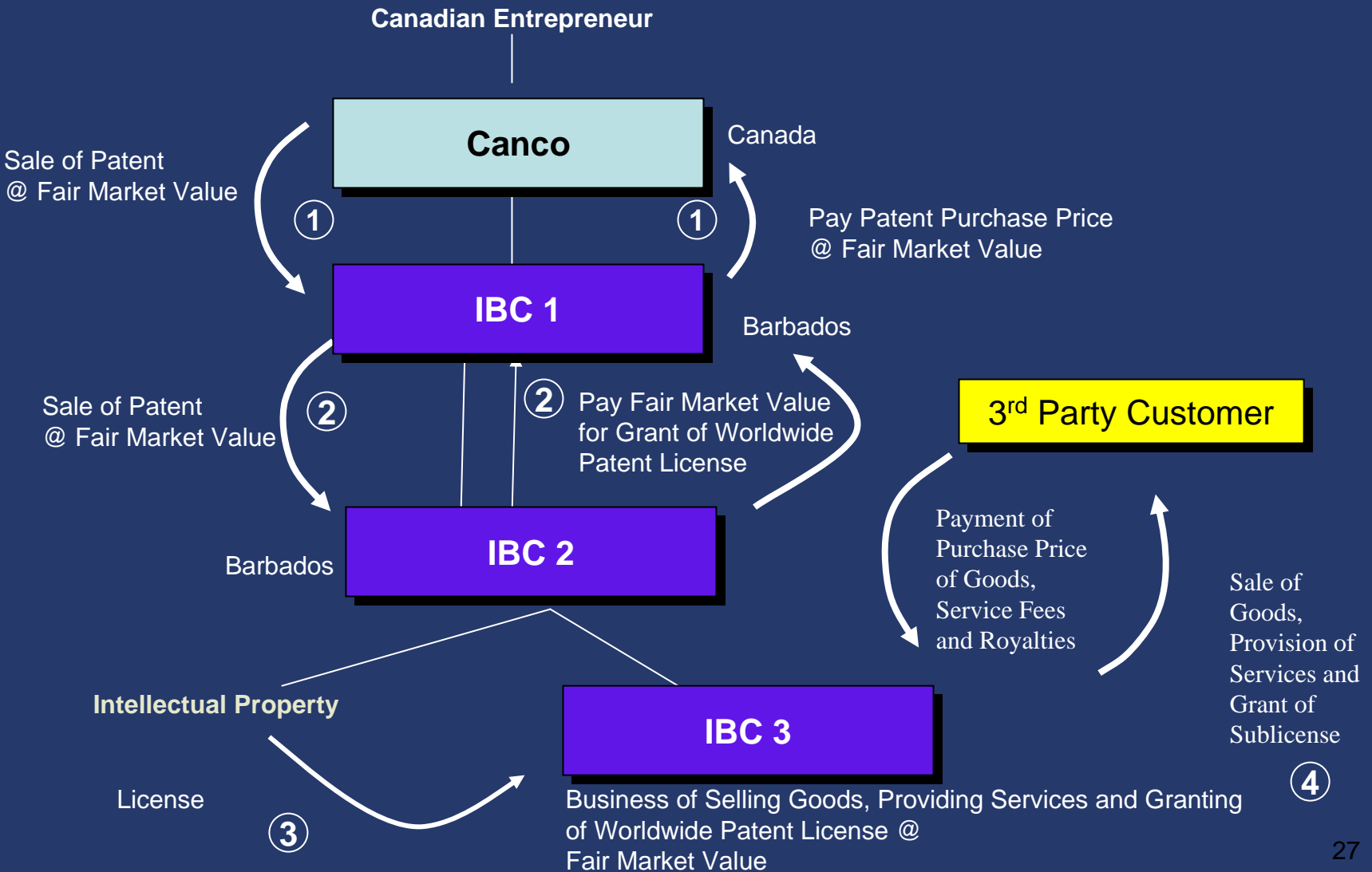


Tax Implications for Canadians: Captive Insurer (*continued*)



- American foreign affiliate obtains deduction for premiums
- Premiums received by Tax Treaty/TIEA captive from American insured may be deemed to be “exempt surplus”
- Premiums received by Tax Treaty/TIEA captive from Canadian insured will be deemed to be FAPI, but deductible insurance reserves may be available, resulting in tax deferral

Tax Implications for Canadians: Ownership of Patent for Canadian-Based Multinational *(continued)*



Tax Implications for Canadians: Ownership of Patent for Canadian-Based Multinational (continued)



- Will Canadian entrepreneur switch from tax treaty country like Barbados to TIEA country like Bahamas?
- Again, looking at tax and non-tax considerations- entrepreneur may have gone to Barbados because of computer-literate work force, which may not be easily replicated in tax haven



- Offshore secrecy will decline/disappear
- Tax administrations are forming collaborative working relationships with their counterparts around the world; they are sharing best practices, methodologies and *information* in an effort to address common cross-border challenges and internal compliance issues



- Voluntary disclosure to CRA will likely increase (compared with U.S. and U.K. it's more likely to induce compliance because of total amnesty that is available)
- Canada must fix its tax system to dissuade evasion
 - lowering corporate tax rates helps, but complex rules that cannot be administered, e.g. FIE and NRT rules, should not be enacted or threatened



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