

Lead Report

Canada's Due Diligence Requirements for APAs Barring Complex Cases from Program, Practitioners Say

The Canada Revenue Agency's new requirements for submitting advance pricing arrangements have been preventing the Agency from accepting difficult cases, practitioners told BNA Tax Management, contending this result is inconsistent with the program's core purpose.

Both U.S. and Canadian practitioners expressed concern with an initiative that requires additional due diligence at the pre-filing and submission stages of an APA. Lucie Bergevin, head of the CRA's International and Large Business Directorate, said in September that the CRA is "asking for more information on certain types of transactions, including transactions involving intangibles, to make an informed decision about whether to accept or reject an APA request" and is "providing more feedback during and after the pre-file meeting to help taxpayers come up with a balanced and complete submission with which the CRA can work" (20 *Transfer Pricing Report* 399, 9/22/11).

Chris Raybould of Baker & McKenzie in Toronto said one reason for the new requirements is that the CRA is reluctant to accept cases likely to become eligible for arbitration. The increased due diligence could end up excluding more complex cases, such as those involving business restructuring and intangibles issues, he said.

"I believe that looking to exclude difficult cases subverts the original purpose of the APA program: specifically, to give taxpayers and tax administrations a means to identify and resolve difficult issues contemporaneously," Raybould said.

François Vincent of KPMG LLP in Ottawa, who was one of the initial architects of the Canadian APA program, agreed.

"I was one of the original three individuals tasked with setting up and running the APA program in Canada at inception and I am the co-author of its original and revised guidelines. I can confirm that the APA program was meant to tackle difficult issues. It was meant to allow taxpayers and tax authorities to get together and work proactively to resolve problems by cooperating in a transparent manner," Vincent said Sept. 30.

Resource Problem?

Fred O'Riordan of Ernst & Young LLP in Ottawa said the tightening of APA entry requirements "appears to be a response designed to address the demand side of the problem by slowing and reducing intake into the program."

O'Riordan, who was the CRA's assistant commissioner of Appeals from 2007 to 2010 and head of the International and Large Business Directorate when it was

created in 2006, noted that international audit resources increased significantly during 2006 and afterward. However, he said, "there has not been a comparable increase in Competent Authority resources, even though one would anticipate a more or less one-to-one relationship, with a slight lag over time, between incremental audit activity in the field and incremental [mutual agreement procedure] cases and APA requests."

More Competent Authority Cases?

Vincent said the net result of denying access could be more double tax cases in Competent Authority.

"If the CRA were to continue restricting access to the APA program and allowing only less complex cases, then it would arguably deny a set of taxpayers access to its top expertise in situations where that expertise is most needed"—and push the more complex cases toward either competent authority or litigation.

If the taxpayer, after failing to get an APA, goes to Competent Authority, "the same CRA Competent Authority team that should have dealt with the particular case as an APA ends up dealing with it anyway as a mutual agreement request," Vincent said. On the other hand, if it goes to court, it will be decided by a judge, who is likely to have relatively little experience in transfer pricing, he said. Further, Vincent noted that the CRA so far has a losing track record in transfer pricing litigation.

Raybould said cases generally are better addressed "while access to all relevant people and data is readily available rather than waiting for years to start an audit and risk it becoming more difficult to resolve as people change jobs or leave and records go into storage."

IRS Policy

Steven Wrappe with Ernst & Young LLP in Washington, D.C. noted that while the Canadian government may be restricting more cases, the IRS has not.

"The U.S. has resisted restricting access to the APA program. The exclusion of difficult issues from the program really runs counter to the reason the APA program was founded," he said.

O'Riordan noted that the United States has encouraged taxpayers with restructuring issues to apply for an APA. "Business restructuring is, after all, the current global reality for many multinational corporations with significant cross-border activity," he said.

Moreover, he said, accepting these cases also is consistent with the Organization for Economic Cooperation and Development's recently released guidance on business restructuring. "Rejecting them is not only inconsistent with OECD guidance, it is inconsistent with the

overall policy direction that the OECD's Forum on Tax Administration is encouraging both tax administrations and taxpayers to take through its 'enhanced relationship' initiative, with which the CRA fully subscribes."

Additional Transactions

Shiraj Keshvani of Deloitte Tax LLP in Ottawa noted that along with requiring more due diligence, the CRA is asking taxpayers to include more transactions as part of their APA requests. For example, he said, "where an APA is requested that involves the payment of a royalty, the CRA may request information or request the coverage of the related intercompany tangible flow or intra-group services."

Keshvani said his understanding is that the new requirements "would not place any new burden on the taxpayer, but only move it forward from the due diligence stage of the APA process to the APA submission stage." Knowledge of the requirements "would better help a taxpayer establish their own suitability to the APA program," he said.

More Clarity

O'Riordan said that if the CRA continues to request increased due diligence at the pre-file stage, it should consider revising its guidance on APAs to provide clearer direction to taxpayers.

The current version of Information Circular 94-4R states that "the APA process is flexible enough to adapt to the facts and circumstances of any particular case" and that the scope and complexity of a case will affect merely the time needed to process a request, O'Riordan pointed out. "If entry is now being restricted, taxpayers should be given clear criteria with examples so they can decide accordingly whether or not to apply," he said.

While Keshvani agreed that the CRA should clearly publish criteria for both suitability and information needs, he suggested taxpayers in the interim take the opportunity to clearly articulate their concerns and constraints.

"Where there is an expressed interest in collaborating, I have observed a willingness on the CRA's part to attempt to accommodate specific issues and concerns while preserving the integrity of the program," he said.

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