Authors
Kenneth Lobo
Stanley C. Ruchelman

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CANADIAN TAX AGENCY IDENTIFIES RULINGS FOR B.E.P.S. EXCHANGES

The Canadian Revenue Agency ("C.R.A.") has categorized several advance pricing arrangements and income tax rulings as information to be exchanged with other jurisdictions in compliance with B.E.P.S. Action 5.[1]

Action Item 5 generally recommends the compulsory spontaneous exchange of information with regard to tax rulings related to preferential tax regimes. A previous edition of *Insights* discussed Action Item 5, noting that:

> [Action Item 5] will introduce an obligation for an individual country to spontaneously exchange information that could be relevant to another country, even when the information has not been requested by the second country. In addition, the Forum on Harmful Tax Practice is authorized to prepare a report on preferential regimes for public dissemination – *viz.*, name and shame.[2]

The following material will be subject to an information exchange by the C.R.A.:

- Cross-border rulings related to preferential taxation regimes, which in Canada include international shipping and some foreign life insurance operations of Canadian entities
- Cross-border rulings related to legislation governing transfer pricing
- Cross-border rulings that provide a downward adjustment that is not reflected in the taxpayer's account
- Rulings on permanent establishment ("P.E.") issues
- Rulings on related-party conduits

The C.R.A. will share this information with the immediate parent's resident country, the ultimate parent's resident country, and "certain other parties." Additional information must be requested from the C.R.A.'s Authority Service Division in accordance with Canadian law.

In light of the Panama Papers revelations, multinational companies ("M.N.C.'s")

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1 Canadian Revenue Agency, "Advance Income Tax Rulings and Technical Interpretations," No. IC70-6R7.

2 Stanley C. Ruchelman and Rusudan Shervashidze, "Action Item 5: Countering Harmful Tax Practices More Effectively," *Insights* 1, no. 9 (2014).

remain vigilant about privacy issues and public opinion. While the Canadian government will only release information pursuant to Canadian law, the law may be altered by a Parliamentary Act. Further, bilateral procedures and subjective processes, such as the differing country-by-country ("CbC") report submission dates, seem to undermine the B.E.P.S. Project's goal of creating a universal, streamlined compliance standard. The B.E.P.S. action items continue to be implemented piecemeal, and questions remain as to whether implementation will actually exacerbate the problem that the B.E.P.S. Project was created to solve: the prevalence of schemes whose principal purpose is the avoidance or evasion of taxes via a disjuncture of rules in two or more countries.

I.R.S. WORKING TO ACCEPT EARLY CBC REPORTS

The I.R.S. previously required that M.N.C.'s submit their CbC reporting to the U.S. by July 1, 2016. However, several other countries required CbC submissions before that date, resulting in an overlap of compliance for M.N.C.'s. The U.S. is attempting to resolve the problem by accepting voluntary CbC reports before its original July 1, 2016 deadline.

Documentation Requirements

In an article previously published in *Insights* which discussed CbC reporting, the following was stated:

Action Item 13 calls for a revamp of transfer pricing documentation. The new guidance calls for a three-tiered approach to global transfer pricing documentation, including:

> 1. A Master File – a high-level overview of the multinational group business;
>
> 2. A Local File – detailed information on specific group transactions for a given country; and
>
> 3. A Country-by-Country ("CbC") report – a matrix of specific data for each jurisdiction, ostensibly to be used as a risk assessment tool by tax authorities (as well as, potentially, taxpayers).[3]

Submissions to Foreign Jurisdictions

Some U.S. corporations are contemplating creating a surrogate foreign parent or submitting CbC reports directly to foreign jurisdictions. M.N.C.'s are concerned that governments may divulge information to the media for partisan political purposes and that the modified CbC submission process will preclude the goal, envisioned in B.E.P.S. Action 13, of creating one universal form.[4] In an attempt to streamline

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[3] Sherif Assef, "Action Item 13: Guidance On Transfer Pricing Documentation and County-By-Country Reporting," *Insights* Special Edition: B.E.P.S. Retrospective (2014).

[4] Michael Peggs, "Country-by-County Reporting: Where Are We Going?," *Insights* 4 (2016).

the reporting process, the I.R.S. is negotiating with foreign jurisdictions to accept voluntary CbC reports from U.S. entities.

B.E.P.S. PROCESS FUELING "GROWTH BUSINESS" FOR MUTUAL AGREEMENT PROCEDURES

Tax practitioners fear that the B.E.P.S. Mutual Agreement Procedure ("M.A.P.") will expand, rather than settle, inter-country disputes, as resolution procedures depend on subjective tests. In an article previously published in *Insights*, which discussed the M.A.P., the following was stated:

> The goal is to provide an objective M.A.P. process that addresses issues in a fair manner based on the rule of law rather than selfish interests. Whether Action 14 will succeed is an open question. In comparison to the other components of the B.E.P.S. Action Plan, the targets of Action 14 are the authorities that set the rules. It is not clear that these officials will have the political commitment to promote fairness over collection of tax revenue.[5]

Additionally, last month's edition of *Insights* addressed the possibility that the B.E.P.S. Project may result in M.N.C.'s hiring full-time compliance officers to oversee cross-border operations. In fact, the I.R.S. itself now intends to employ full-time compliance officers to police B.E.P.S.

M.N.C.'s are anxious as to whether the resources exist to resolve M.A.P. issues within 24 months of binding arbitration. The I.R.S. remains convinced that binding arbitration and M.A.P.S. will incentivize taxpayers to resolve disputes. The question that persists is whether taxpayers will resolve B.E.P.S. matters under the belief that the I.R.S. is "correct," or whether disputes will be resolved solely to avoid costly B.E.P.S.-related litigation.

NEW RULE FORCES FINANCIAL INSTITUTIONS TO TRACK "BENEFICIAL OWNERS" OF CERTAIN FOREIGN ENTITIES

New Regulations

Last week, the I.R.S. published a final rule regarding financial institutions and the identification of their clients. The rule requires a covered financial institution ("C.F.I.") to identify clients that are "beneficial owners" of certain entities.[6] C.F.I.'s include banks, brokers, dealers, mutual funds, commission merchants, and commodity brokers. Client information will be required whenever companies incorporate or

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[5] Stanley C. Ruchelman and Sheryl Shah, "Action Item 14: Make Dispute Resolution Mechanisms More Effective," *Insights* Special Edition: B.E.P.S. Retrospective (2014).

[6] "Customer Due Diligence Requirements for Financial Institutions," Department of the Treasury (May 2, 2016).

transfer ownership of a C.F.I. into the U.S. Compliance will not be mandatory until May 18, 2018.

C.F.I.'s must verify the identification of a "beneficial owner" of an entity when an account is opened. A "beneficial owner" is an individual who owns more than 25% of the equity interests in the entity, or a single individual who exercises control over the entity. The entity must also identify a "senior manager" that the I.R.S. can contact with inquiries.

"In the future, the I.R.S. could force compliance by refusing to issue an employer identification number ('E.I.N.') to any entity that did not disclose its information on an E.I.N. application."

Entities affected by the new rule include corporations, partnerships, limited liability corporations, general partnerships, and any similar foreign entity that opens an account. Practitioners should note that certain entities are excluded from this list, including trusts, sole proprietorships, and unincorporated associations.

Practically, C.F.I.'s will rely on the information provided by their clients and are not required to confirm this information, unless the C.F.I. has knowledge that the submitted information is fraudulent. C.F.I.'s must also update their records if changes are discovered during routine reviews. The information is to be entered into a database. Records must be kept for five years after an account is closed.

Criticism

Evasive clients may still provide financial institutions with falsified documents, allowing the institution to comply with the rule but thwarting the I.R.S.' attempts to uncover the identity of the "true" owner. Entities may also list an individual as a "senior manager" even though even though he or she would have no real responsibilities, thereby hindering I.R.S. investigations.

The entity could also restrict individual ownership interests below 25% to evade the new rule. Industry groups note that the information received from clients may range from fully transparent to opaque, with the C.F.I. bearing responsibility for determining the truth. Finally, multinational entities may require additional personnel to track various internal ownership changes that take place within a consolidated group.

In the future, the I.R.S. could force compliance by refusing to issue an employer identification number ("E.I.N.") to any entity that did not disclose its information on an E.I.N. application, since an E.I.N. is generally required to open a bank account within the U.S.