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Global Tax Alert

News from Americas Tax

OECD releases Canada Stage 2 peer review report on implementation of Action 14 minimum standard

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Executive summary

On 13 August 2019, the Organisation for Economic Co-operation and Development (OECD) released the Stage 2 peer review report of Canada relating to the outcome of the peer monitoring of the implementation of the Base Erosion and Profit Shifting (BEPS) minimum standard under Action 14 on improving tax dispute resolution mechanisms. Stage 2 focuses on monitoring the follow-up of any recommendations resulting from Canada's Stage 1 [peer review report](#).¹ Canada requested that the OECD also provide feedback concerning its adoption of the Action 14 best practices, and therefore, in addition to the peer review report, the OECD has released an [accompanying document](#) addressing the implementation of best practices.

Overall, the report concludes that Canada addressed most of the shortcomings identified in its Stage 1 peer review report. These shortcomings principally included issues with Canada's treaties related to time limits for Mutual Agreement Procedure (MAP) submission and settlement implementation, and the absence of time limits for making transfer pricing adjustments.

Detailed discussion

Background

In October 2016, the OECD released the [peer review documents](#) (i.e., the Terms of Reference and Assessment Methodology) on Action 14 which form the basis of the MAP peer review and monitoring process under BEPS Action 14.²

The Terms of Reference translate the minimum standard approved into a basis for peer review, consisting of 21 elements complemented by 12 best practices. The Terms of Reference assess a Member's legal and administrative framework, including the practical implementation of this framework to determine how its MAP regime performs relative to the 21 elements in four key areas: (i) preventing disputes; (ii) availability and access to MAP; (iii) resolution of MAP cases; and (iv) implementation of MAP agreements.

The Assessment Methodology establishes detailed procedures and guidelines for a two-stage approach to the peer review and monitoring process. Stage 1 involves the review of a Member's implementation of the minimum standard based on its legal framework for MAP and the application of this framework in practice. Stage 2 involves the review of the measures taken by the Member to address any shortcomings identified in its Stage 1 peer review. In light of the above, the OECD has also released a schedule for Stage 1 of the peer review and a questionnaire for taxpayers. The schedule catalogues the assessed jurisdictions into 10 batches for review.

Both of these stages are desk-based and are coordinated by the Secretariat of the Forum on Tax Administration's (FTA) MAP Forum.⁴ In summary, Stage 1 consist of three steps or phases:

- (i) Obtaining inputs for the Stage 1 peer review
- (ii) Drafting and approval of a Stage 1 peer review report
- (iii) Publication of Stage 1 peer review reports

Input is provided through questionnaires completed by the assessed jurisdiction, peers (i.e., other members of the FTA MAP Forum) and taxpayers. Once the input has been gathered, the Secretariat prepares a draft Stage 1 peer review report of the assessed jurisdiction and sends it to the assessed jurisdiction for its written comments on the draft report. When a peer review report is finalized, it is sent for approval of the FTA MAP Forum and later to the OECD Committee on Fiscal Affairs (CFA) to adopt the report for publication.

For Stage 2, there are two steps or phases: (i) approval of the Stage 2 peer monitoring report of an assessed jurisdiction and (ii) publication of the Stage 2 peer review reports. More specifically, an assessed jurisdiction should within one year of the adoption of its Stage 1 peer review report by the CFA submit a detailed written report (Update Report) to the FTA MAP Forum. The Update Report should contain: (i) the steps that the assessed jurisdiction has taken or is taking to address any shortcomings identified in its peer review report; and (ii) any plans or changes to its legislative or procedural framework relating to the implementation of the minimum standard. Members of the FTA MAP Forum should also provide their comments on the Update Report provided by the assessed jurisdiction. Based on the Update Report submitted by the assessed jurisdiction and the input from the peers, the Secretariat will revise the Stage 1 peer review report of the assessed jurisdiction with a view to incorporate these updates in the Stage 2 peer monitoring report of the assessed jurisdiction. After adoption from the CFA, the Stage 2 peer monitoring report will be published.

Minimum standard peer review reports

The report is divided into four parts, namely:

- (i) Preventing disputes
- (ii) Availability and access to MAP
- (iii) Resolution of MAP cases
- (iv) Implementation of MAP agreements

Each part addresses a different component of the minimum standard. A summary table of the applicability of the Action 14 recommendations to Canada's treaty network is presented as Appendix A to the report.

Overall, Canada addressed most of the shortcomings identified in its Stage 1 peer review report. Canada deposited its instrument of ratification with the Depositary of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the MLI) on 29 August 2019. The MLI will enter into force for Canada on 1 December 2019. Accordingly, it will enter into effect for any particular covered tax treaty in accordance with the provisions of Article 35 of the MLI, and will apply to some of Canada's tax treaties with effect as early as 1 January 2020.

Highlights of the Canada Stage 2 report and best practices peer review report

Preventing disputes

Canada has two existing treaties (with Australia and France) that do not contain language equivalent to the first sentence of Article 25(3) of the OECD Model Tax Convention, which requires competent authorities to endeavour to resolve by mutual agreement any doubts or difficulties arising as to the interpretation or application of the treaty. Canada has signed the MLI, and the two treaties are covered tax agreements under the MLI, so upon the coming into force of the MLI the two treaties will be modified to include the equivalent of the first sentence of Article 25(3) of the OECD Model Tax Convention. Further, Canada reported that it will seek to include Article 25(3), first sentence, of the OECD Model Tax Convention in all of its future treaties.

Subject to certain conditions, Canada allows roll-backs for bilateral APAs, in line with recommendations of Action 14. Canada does not anticipate any modifications regarding this element.

Availability and access to MAP

Currently, 80 of Canada's 96 tax treaties do not contain a provision equivalent to the second sentence of Article 25(1) of the OECD Model Tax Convention allowing taxpayers three years from an action giving rise to taxation not in accordance with the convention to file a MAP request. Upon the coming into force of the MLI, it is expected that 47 of these 80 treaties will be modified to a minimum three-year standard, and there are pending bi-lateral negotiations with several other countries. Canada reported that it will seek to include the equivalent of Article 25(1), second sentence, of the OECD Model Tax Convention in all of its future tax treaties.

Currently, nearly all of Canada's treaties contain a provision equivalent to the first sentence of Article 25(1), which allows a taxpayer to make a MAP submission to either Competent Authority. Further, Canada has made an MLI reservation that will prevent modification of its treaties in this regard. Canada reported it maintains a view that a taxpayer must file a MAP request with the Competent Authority of its country of residence in accordance with its treaties, but allows that a MAP filing of a related party to the foreign Competent Authority will be considered as notification of its related party in Canada under the treaty where Canada is informed of the filing. Canada is currently updating its administrative guidance in this regard.

Canada's MLI reservations will preclude modifications of treaties to clarify access to MAP for Article 9 transfer pricing cases. However, Canada considers that Article 25(3) allows for MAP treatment of transfer pricing cases. No denial of access to MAP for transfer pricing cases has been noted.

Canada does not restrict access to MAP in cases where treaty or domestic anti-avoidance provisions are cited, but rather considers that the issue of whether such provisions are in conflict with the treaty is within the scope of the MAP.

Resolution of MAP cases

Action 14 provides that jurisdictions should seek to resolve cases within a 24-month average timeframe. Canada reported an average timeframe for resolution of MAP cases as 20.91 months over the reporting period. Approximately 80% of cases were attribution/allocation cases (transfer pricing).

Of 301 cases closed during the reporting period, 74% were resolved by an agreement fully eliminating double taxation or taxation not in accordance with the treaty; 9% were resolved by granting unilateral relief; 5% were withdrawn by the taxpayer; 4% were resolved by agreement that there was no taxation that was not in accordance with the treaty; and the rest were closed with various results, including 1% that were closed with no agreement between the Competent Authorities.

Canada has no domestic law limitations precluding MAP arbitration and has opted for mandatory binding arbitration under the MLI. Currently, Canada has included an arbitration clause in 21 of its 96 tax treaties. A further 15 treaties may be modified once the MLI is in effect, depending on Canada's and the treaty partners' specific notifications.

Implementation of MAP agreements

Action 14 recommends that all MAP agreements reached should be implemented. In addition it recommends that all MAP agreements should be implemented on a timely basis. Canada reports being able to implement MAP agreements, subject to the taxation years not being domestically statute-barred, which taxpayers can preclude by filing waivers. Canada will not override domestic statute time limits unless they are specifically overridden by a treaty. Of Canada's 96 treaties, 36 do not support override of Canadian domestic time limits, and due to Canada's reservations, these treaties will not be modified in this respect by the MLI, once implemented.

MAP agreements are implemented in a timely manner, but the Canadian Competent Authority has no authority to direct prioritized processing of assessments arising from MAP settlements.

Best practice peer review report

Canada reports that it has issued updated guidance that sets out the conditions under which it will allow MAP consideration of taxpayer-initiated foreign adjustments.

Canada remains amenable to considering multilateral MAP cases.

Canada is not in line with the recommended best practice to suspend collection procedures during the period a MAP case is pending. Large corporations are required to pay or secure 50% of income tax, interest, and penalties and 100% of withholding tax, interest, and penalties due even when a MAP is initiated. Canada notes, however, that acceptance

into MAP is not dependent on payment of tax in advance and that the suspension of collections provisions under MAP are the same conditions applicable to taxpayers under domestic or judicial remedies.

Implications

In a post-BEPS world, where multinational enterprises (MNEs) face tremendous pressures and scrutiny from tax authorities, the release of Canada's Stage 2 peer review report represents the continued recognition and importance of the need to achieve tax certainty for cross-border transactions for MNEs. While increased scrutiny is expected to significantly increase the risk of double taxation, the fact that tax authorities may be subject to review by their peers should be seen by MNEs as a positive step to best ensure access to an effective and timely mutual agreement process.

Endnotes

1. See EY Global Tax Alert, [OECD releases Canada peer review report on implementation of BEPS Action 14 minimum standards](#), dated 2 October 2017.
2. See EY Global Tax Alert, [OECD releases BEPS Action 14 on More Effective Dispute Resolution Mechanisms, Peer Review](#), dated 31 October 2016.
3. See EY Global Tax alert, [OECD releases schedule of Action 14 peer reviews](#), dated 1 November 2016.
4. <http://www.oecd.org/tax/forum-on-tax-administration/about/>.

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