

Reform of International Tax: Canada, Japan, United Kingdom and United States

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Advisory Panel on Canada's System of International Taxation



Principles to Guide Canadian International Tax Policy

- Competitive tax system for Canadians investing abroad
- Level playing field for domestic business activity
- Protect Canadian tax base
- Straightforward tax rules
- Open consultation
- Regular benchmarking

Canada

Taxation of Foreign Business Income

Assessment of current system

- “Hybrid” system inconsistent with international norms
- Significant compliance/administrative burden on taxpayers and CRA to track “deferred” income, but for what purpose? Deferred income never taxed!!
- Should exemption system be linked to tax treaties/TIEAs?
- Advisory Panel recommendation:
 - Move to a full exemption system for foreign active business income **including** capital gains/losses on sale of shares of foreign affiliates carrying on such activities

Canada

Taxation of Foreign Passive Income (FAPI)

FAPI regime reflects underlying principle that there is no good reason for Canada's tax system to favour *foreign* over domestic passive income

Future Challenges

- Implications of moving to a full exemption system for foreign active business income – should **all** foreign passive income of all foreign affiliates (not just controlled affiliates) be taxed on an accrual basis?
 - Compliance issues?
- Ensuring base erosion rules do not negatively impede current (global) business practices

Canada

Expense Allocation

No current rules to attribute domestic expenses to foreign exempt or deferred income

In 2007, business community strongly opposed proposed restriction on interest expense incurred with respect to funds borrowed to invest in foreign affiliates

“ Canadian businesses need flexibility in raising capital and structuring the financing of their foreign acquisitions and expansions to be competitive with businesses based in other countries. In the Panel’s view, this pragmatic concern is of greater weight than the theoretical basis for denying interest deductions on money borrowed to invest in foreign companies or in respect of outbound financings arrangements.”

*- Advisory Panel on Canada’s System of International Taxation,
Final Report*

Canada

Expense Allocation (cont'd)

End of story in Canada?

- Advisory Panel left door open to restrict deductibility of interest on funds borrowed by *foreign controlled* Canadian companies investing in foreign affiliates in certain circumstances
 - Example of “debt dumping”

Thank you.

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