



PANELISTS

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BASIC COMPLIANCE REQUIREMENTS

- Budget 2009 update
- Continuing conditions of registration
- Transfer pricing
- Filing returns
- Cost allocation
- Refund calculation & example
- Offences and penalties
- IFA Specialists



BASIC COMPLIANCE REQUIREMENTS

BUDGET 2009 UPDATE

- Discretion to relax 90-day amalgamation notification requirement
- Expanded patent list to wastewater treatment and fuel cell technology
- Non-resident person to exclude a Canadian branch of a non-resident



BASIC COMPLIANCE REQUIREMENTS

CONTINUING CONDITIONS OF REGISTRATION (Sec. 12)

- Incorporated in Canada and not continued in foreign jurisdiction
- BC permanent establishment
- Not exempt under ITA
- Carry on an IFB business
- Membership in IFC BC
- Keep books and records in BC
- Supply information under the IFAA
- No false or misleading information
- Do not commit an offence under the IFAA



BASIC COMPLIANCE REQUIREMENTS

TRAPS

- Amalgamations or wind-ups
- 90-day rules to advise for amalgamations
- Different legal entity requires new registration
- Name changes—advise Ministry and IFC BC
- Commissioner has wide discretion to cancel or suspend registration (retroactive)



BASIC COMPLIANCE REQUIREMENTS

TRANSFER PRICING (Sec. 20)

Issues to consider when setting a transfer price

- Transactions between related parties and affiliated corporations must be valued at fair market value as if the parties were dealing at arm's length.
- Transfer pricing documentation accepted by CRA for purposes of ITA Sec. 247 would be acceptable.
- If the transaction is not at fair market value the Commissioner may set the transaction price to reflect fair market value.
- The IFAA does not establish guidelines, but adopts guidelines similar to those in *Income Tax Act* (Canada).
- No formal requirement for transfer pricing study but may have to demonstrate reasonable efforts were made in order to avoid penalties (see below).

Penalties for Offenses (Sec. 36 (3))

- Penalty of 10% of transaction price adjustment (exception if the taxpayer can prove "reasonable efforts" to determine appropriate arm's length price).
- Document! Details of transactions, analysis, etc. to support your claim.

FILING RETURNS

- May file return within 18 months after taxation year
- Can file later if approved by commissioner
- Ability to demand return from registrant
- Use Form Fin 578
- Attach F/S, T2, Notice of (Re)Assessment, CRA Statement of Account, Other info
- Refund is not taxable in year received under ITA 12(1)(x) if election is made under ITA 12(2.2)
- No refund to claim, not required to file return
- BC tax reassessed by CRA → 90 days to revise claim

COST ALLOCATION (Sec. 19)

- Allocation method should be reasonable in the circumstances and substantiate the amount claimed.
- IFAA, Section 19 deals with allocations and states that companies must deduct all amounts that relate to IFB and have been deducted in determining income or loss under the *Income Tax Act* (Canada).
- Overhead can be charged as an allocation based on revenue as long as it is reasonable and can be justified by a business case. In some cases, the Audit Dept. will compare companies in the same business.
- Consistency between years is not necessary, however a lack of consistency may lead to more audit inquiry.
- Allocations should be based on some rationale that is reasonable.
- Must allocate all costs 'that relate to' the IFB.
- Once again, documentation is critical to making your case to audit and claiming your full refund.
- Advantages of separate legal entity (?)

BASIC COMPLIANCE REQUIREMENTS

REFUND CALCULATION

$$\frac{\text{IFB Income}}{\text{Adjusted Net Income}} \times \frac{\text{BC Taxable Income}}{\text{Federal Taxable Income}} \times \text{BC Tax}$$

- Limited to BC tax paid
- Impact of losses carried back or forward
- Intuitively, formula should give IFB income x BC tax rate

Other issues regarding refunds

- Use 6 decimal points in all calculations
- All refund paperwork should be sent by signed receipt mail.
- The corporation must notify the ministry within 90 days of any income tax reassessment that may impact the calculation of the tax refund.

BASIC COMPLIANCE REQUIREMENTS

REFUND CALCULATION EXAMPLE

- IFB income determined based on income attributable to BC PE
- Adjusted income is based on allocation formula for net income allocated to BC— allocation of income based on wages and revenues will not be the same as BC income/Canada income.

BC IFB Income	=	\$ 100	
Other BC income	=	Nil	
Allocation % to BC	=	25%	
Canadian taxable income	=	\$ 300	
Refund	=	$\left[\frac{100}{300 \times 25\%} \right] \times (75 \times 11\%) \left. \vphantom{\frac{100}{300 \times 25\%}} \right\} \text{BC Tax= Cdn taxable income} \times 25\% \times 11\%$	
	=	$\left[\frac{100}{75} \right] \times 8.25 - \text{Limited to } \8.25	

OFFENCES (Sec. 62)

Applied in these situations

- False or misleading information
- Obstruct, hinder or interfere with the commissioner
- Obtain tax refund through false misleading statement
- Destroying, hiding, altering or disposing of a record
- Making a false or misleading entry
- Omitting a material particular in a record
- Due diligence defense
- Offenses of corporation apply to employees, officers, directors, agents who authorize, permit or acquiesce in the offence

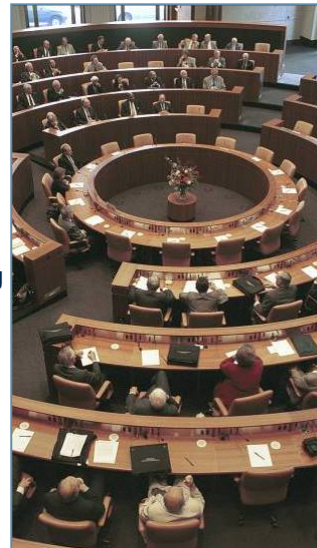
Penalties for Offenses (Sec. 63)

- Fine of ≤ \$100,000 and/or 12 months
- Plus 50% to 200% of excess refund

IFA SPECIALISTS

A registered company can apply to register an employee as an IFA Specialist.

- Specialists receive up to 75% refund of BC tax on IFA employment income for a maximum of five years. Maximum marginal tax rate drops from 43.7% to 32.675%.
- Must be transferred from outside of Canada to provide a specific expertise and have a written employment agreement in place prior to becoming resident in Canada.
- 70% of the individual's working time is spent on international financial activities.
- The maximum term is 5 years.
- There is no fee to register an IFA Specialist.
- Exclusion for patent activities, management services, administrative support, back-up services



BASIC COMPLIANCE REQUIREMENTS

 **International Financial Centre** // 13
BRITISH COLUMBIA

PANEL QUESTIONS

Is there a requirement for a registrant to file a return for a particular year when there is a loss and no BC tax payable?

If there is no BC tax payable, the registrant is not required to file a IFA return. However, the Province can demand that a return be filed and then it is a requirement to file. In situations where there is a loss carryback, we understand that the Province will ask that missing returns be filed.

If a registrant has a loss year, but elects under S110.5 of ITA to utilize Foreign Tax Credits, can an IFA Refund claim be made?

An S110.5 election will create taxable income and therefore BC tax payable. If there is BC tax payable, an IFA Refund claim can be made. If losses are not in the IFB, the rate of IFB business to non-IFB business may be higher.

QUESTIONS: SESSION 1

 **International Financial Centre** // 14
BRITISH COLUMBIA

PANEL QUESTIONS

Is a registrant required to keep books and records in BC?

This is a requirement under the International Financial Activity Act (IFAA). However, companies with head offices outside BC can obtain approval from the Province to keep books and records outside BC as long as they agree to make them available in BC, particularly during audit. With the ability to transfer information electronically, this should not be a constraint.

What are some of the traps involved with maintaining registration where a registrant has been involved in a corporate reorganization?

Registration in the IFA program is for a specific company, so any new company that is formed must be registered. In general, there are three situations: 1) an amalgamation of registrants—the registration carries through to the new entity; 2) an amalgamation with a non-registrant—there is a 90-day notification requirement; 3) a windup of a registrant—a new registration is required for the continuing entity. In situations of a name change, registrants can notify the Province on the next return.

QUESTIONS: SESSION 1 **International Financial Centre** // 15
BRITISH COLUMBIA**PANEL QUESTIONS**

How can the functional currency election simplify compliance under the IFA Act?

A registrant has the ability to elect to use certain foreign currencies (US dollar, Euro, or British Pound) for filing income tax returns. Electing to file under a functional currency avoids the need to hedge foreign currency and minimizes compliance by maintaining books in US \$ or another allowed currency. The Province has indicated that they will allow the use of foreign currencies as allowed by the ITA. Since the IFA refunds rely on ratios of amounts as determined for filing the federal T2, there should not be any issue with the calculations using foreign currencies as permitted under the ITA. The amount of BC tax will be converted at the relevant exchange rate into Canadian dollars on the same basis as federal income taxes.

QUESTIONS: SESSION 1 **International Financial Centre** // 16
BRITISH COLUMBIA

PANEL QUESTIONS

What should a registrant do to file an IFA Claim if the CRA has not assessed the return within the 18 month filing period after the taxation year?

The registrant should file the return within the specified time based on the T2 information. The CRA Assessment should be provided as soon as possible since interest will not start until it is received.

Many registrants carry on both qualifying and non-qualifying activities in the same legal entity. What methodologies are registrants using to allocate costs such as overhead and salaries in calculating IFB income?

Registrants must deduct all amounts which relate to the IFB. Costs must be reasonable and substantiated by audit trails. There are a variety of allocation methods available including OECD branch allocation guidelines, revenue allocation, and other methods that may apply to a business. Non-arm's length costs are allocated at FMV. It is important that allocation methodologies are revisited periodically to ensure the basis of allocation is still appropriate.

PANEL QUESTIONS

Some registrants have non-arm's length charges as part of their arrangements to utilize the IFA Program (e.g., a captive factoring arrangement). What are the documentation requirements under the IFAA for non-arm's length charges?

It is the responsibility of the registrant to come up with a methodology for transfer pricing. The Province will generally allow what the CRA accepts for transfer pricing. There is no formal documentation requirement, but a registrant must be able to substantiate reasonable efforts to avoid the 10% penalty on IFB income adjustments. Again, registrants should review non-arm's length charges regularly for changes e.g., discount rate for factoring arrangements.

ADMINISTRATIVE REQUIREMENTS

- Rulings and Technical Interpretations
- Audits
- Assessments
- Assessment period
- Interest
- Appeals
- Amended Returns



ADMINISTRATIVE REQUIREMENTS

 International Financial Centre // 19
BRITISH COLUMBIA

RULINGS AND TECHNICAL INTERPRETATIONS

- Ministry issues written advance rulings and technical interpretations to explain technical matters relating to the IFAA.
- No cost, however, professional assistance is recommended.
- Previous rulings are available on the Ministry's website:
www.sbr.gov.bc.ca/business/Income_Taxes/International_Financial_Activity/rulings.htm.

Technical interpretations

- How would the IFAA apply to a generic fact situation
- Apply to hypothetical fact situations, non-binding
- "This letter is not a ruling and consequently is not binding on the Ministry of Finance (formerly Small Business and Revenue)."

ADMINISTRATIVE REQUIREMENTS

 International Financial Centre // 20
BRITISH COLUMBIA

RULINGS AND TECHNICAL INTERPRETATIONS

Advance Rulings

- Sets out how the IFAA applies to a clearly defined fact situation.
- Given on proposed transactions which are seriously contemplated and are not of a hypothetical nature.
- Cannot be provided on transactions already completed or on issues already under review or audit.
- “We provide advance rulings only where transactions are proposed. An advance ruling will not be given as we understand xxx is currently conducting the transactions referred to in your letter...”
- “Please note advance rulings are intended to enable taxpayers to decide on a particular course of action provided the relevant facts and the proposed transactions as set out in the application for the ruling and summarized above are correct and complete and the proposed transactions are carried out as described, our ruling is as follows:”
- “This advance ruling ceases to be valid if the law on which it is based is subsequently changed as a result of a court decision or if the legislation on which the ruling is based is subsequently amended.”

ADMINISTRATIVE REQUIREMENTS

 International Financial Centre // 21
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AUDITS

- All registrants are subject to audit. The MOF’s target is to begin an audit within 45 days after a registrant files.
- In general, the Audit Department will audit **before** refund is paid—especially for the first time filer.
- In general, must be able to provide documents to support your claim.
- Note Appendix 3 of the *Guide to Filling Out Either the IFA Tax Refund of a Corporation or the IFA Tax Refund of a Life Science Corporation (FIN 546/578)*. This is a checklist of required documents.
- Interest becomes payable 61 days after all information in the checklist is received.
- In general, the time required for the first audit is significantly reduced by the second.
- Audit trails must be available, particularly regarding allocation of overhead, proof that one side is a non-resident, etc.

ADMINISTRATIVE REQUIREMENTS

 International Financial Centre // 22
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ASSESSMENTS

Notice of determination

- Province sends out a notice of determination
- Refund is not payable until both the CRA and Province are paid (within 3 years of the end of the taxation year, section 158 of federal Act)
- Copy of the CRA Notice of Assessment must be filed with the MOF with your return.
- Event if you do not receive a Notice of Assessment, you must still file within 18 months of the taxation year.
- If the Notice of Assessment has not been received, you must provide a written explanation.

Subsequent Reassessments (Sec.25)

- Registrant has 90 days after notice was issued to advise Province
- Penalty for not doing so is \$25/day (minimum of \$100 and maximum of \$2,500) plus 25% of excess refund

ASSESSMENT PERIOD

- Period during which assessments or reassessments can be made
 - Similar to rules in ITA
 - No time limit for
 - Fraud/misrepresentation
 - Waivers
 - Waiver of penalties/interest
 - Decisions re: appeals
 - Normally 1 year after ITA time period
 - For ITA reassessments, can extend normal time to 1 year after notification either by registrant or CRA
- Practically, most refund claims will be settled after audit

INTEREST PAYABLE BY THE PROVINCE (Sec. 33 (2) and (3))

Amount

- Calculated daily, compounded monthly.
- Rate is 2% below Prime for the 3 months (as at 15th of month preceding the periods beginning Jan. 1, April 1, July 1, and October 1). Prime is determined as at 15th of the month preceding the 3-month period. (*IFA Regulation 3 (1)*)

Situations when interest is paid

- Province delays a refund payment
 - Interest begins accruing the earlier of
 - 61 days after all paperwork is received by the Ministry (proof of receipt will be helpful here in the event of a disputed date)
 - Or the date of the initial notice of determination

INTEREST PAYABLE BY THE REGISTRANT (Sec. 35 (2))

Amount

- Calculated daily, compounded monthly.
- Rate is 3% above prime (rate is set as of the 15th day of the month preceding the period specified) for the 3 months preceding.
- 3 months periods are Jan. 1, April 1, July 1, and October 1. (*IFA Regulation 3 (1)*)

Situations when interest is paid

- On excess amounts paid due to loss carrybacks—paid on portion recovered.
- For any portion recovered due to a penalty.
- Charged on the date the initial notice of determination for the taxation year was served until the excess amount is paid except for loss carrybacks.
- For loss carrybacks, interest is charged from the date of reassessment for loss carryback.

APPEALS (Sec. 38)

What can you appeal?

- Refused registration
- Registration suspended or cancelled
- Determination of refund or interest
- Administrative penalty
- Not satisfactory proof for payment of Federal and BC taxes
- Effective date of your registration

Level of appeals

- Minister of Finance
- BC Supreme Court
- BC Court of Appeal

APPEALS (Sec. 38)

Appeal to the Ministry

- Although 90 days is the specified time, in reality, it may be somewhat shorter:
 - Must be filed within 90 days of the date of the Notice under dispute
 - There does not appear to be any ability to accept Appeals after 90 days
- Separate notice must be filed for each year
- All appeals must be in writing.
- Taxes, interest, and penalties are payable even while a matter is under appeal

Appeal to the Court

- 90 days to file
- Seek legal advice

AMENDED RETURNS

Reasons for an amended return

- Errors in previous return
- CRA Reassessment
- Changes to taxable income as a result of losses carried forward or back
- Anything else that changes the calculation of the tax refund
- Note: If a Notice of Reassessment is received from the CRA, you must notify the Ministry within 90 days of the notice issue date

Required paperwork

- Note explaining the amendment and reasons for the amendment
- Copy of revised financial statements, if applicable
- Copy of amended T2 return including T2 SCH427, if applicable
- Any balance, send check to MOF

ADMINISTRATIVE REQUIREMENTS

 International Financial Centre // 29
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PANEL QUESTIONS

What happens when all of the information, including the CRA Assessment is filed and subsequently, the registrant received a CRA Reassessment?

Interest is normally payable starting 61 days after the return is filed with required information. It could be later if the claimant has not filed proof of payment of BC and Federal taxes. After a recent appeal, Province agreed to pay interest starting 61 days after the return was filed and the CRA Assessment provided.

If a registrant starts claiming for new activities under the IFA Program, which were not part of the original program, is there a requirement to make a new registration request?

No, it is not necessary to amend or renew registration for new activities. However, the information required in filing the tax refund claim requires registrants to advise of any changes in qualifying activities, related or affiliated corporations, directors and contact information (See 'Appendix 3' of the Province's *Guide To Filling Out Either the IFA Tax Refund of a Corporation or the IFA Tax Refund of a Life Science Corporation.*)

QUESTIONS: SESSION 2

 International Financial Centre // 30
BRITISH COLUMBIA

PANEL QUESTIONS

Is the IFA refund taxable in calculating taxable income in a subsequent year?

The IFA refund would be included in income, when received, under paragraph 12(1)(x) as a government subsidy. However, there is the ability to elect under subsection 12(2.2) such that there is no net income inclusion. Election must be made with respect to the year a refund is received, although there is the ability to file the election for up to 10 years. A specific form is not prescribed, and a registrant can attach the election to the Federal return.

QUESTIONS: SESSION 2

 International Financial Centre // 31
BRITISH COLUMBIA

PANEL QUESTIONS

A registrant is assessed by CRA, which results in an increased tax liability and an increase in the IFA refund available. The registrant decides to appeal the CRA Assessment and pays only 50% of the tax owing. What is the registrant required to do with respect to the IFA Refund Claim?

Registrants must advise the Province of a CRA Reassessment made within 90 days of the date the CRA Reassessment was issued. The Province will not pay the refund until the registrant demonstrates that both federal and BC tax have been paid within 3 years. Registrants who fail to pay within 3 years will need an extension from the Province.

QUESTIONS: SESSION 2

 International Financial Centre // 32
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PANEL QUESTIONS

Panelists were asked: what areas of the program are underutilized?

- Many registrants are not claiming all of the activities they can claim. The list of IFA activities should be reviewed on a regular basis to determine if any aspects of a business qualifies.
- Review transfer pricing rates on an annual basis.
- There are underutilized cost allocation opportunities.
- The IFA Specialist category is not being used by most registrants. If your business can benefit from bringing someone from outside Canada to transact IFA business, the employee can qualify for a 75% refund of their BC taxes for a five-year term. Note this does not apply to patent, administration, back-up operations, and management services activities

QUESTIONS: SESSION 2

 International Financial Centre // 33
BRITISH COLUMBIA

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 International Financial Centre // 34
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