THE TAX HAVENS PHENOMENON

ASSEMBLÉE NATIONALE
QUÉBEC
Place aux citoyens

OBSERVATIONS, CONCLUSIONS AND RECOMMENDATIONS

COMMITTEE ON PUBLIC FINANCE

MARCH 2017

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COMMITTEE ON PUBLIC FINANCE

MARCH 2017

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MESSAGE FROM THE CHAIR AND VICE-CHAIRS

We are pleased to present the report by the Committee on Public Finance on the use of tax havens for the purposes of tax evasion and avoidance. On February 25, 2015, Committee members unanimously agreed to initiate an order to explore tax havens and make recommendations on how to counter their use, which has appeared to be on the rise in recent years. Committee members then unanimously adopted their report on the issue twenty-five months later. They are proud to note that the Committee acted in an entirely nonpartisan manner.

This report is the culmination of a long process involving extensive research and public consultations and hearings. Committee members observed that the impact of taxpayer use of low tax jurisdictions raised concerns for most witnesses and members of the general public. Concerns included how tax evasion ate into government revenues, placing an unfair burden on law-abiding taxpayers and eroding the government's ability to fund public services. Members also noted that this "cancer on the international economy" as some have called it has galvanized governments and citizens throughout the industrialized world, particularly in the European Union, the United States, and Australia.

While the Committee was carrying out its investigation, multiple tax haven scandals hit the news, provoking public outcry in many different countries. Over the past year alone, the world was rocked by revelations on the Panama Papers, the Bahamas Leaks, the KPMG U.S. affair and the KPMG Canada affair. These scandals served to strengthen the resolve of Committee members to investigate the phenomenon. The scandals also shaped the recommendations in this report and showed how urgent it was for them to be implemented.

A number of elected members not serving on the Committee took part in the discussion and provided input. We offer our sincerest gratitude to all participating National Assembly members, whether on the Committee on Public Finance or not.

This report also owes a debt of gratitude to the hard work and highly professional support of many National Assembly staff members. We greatly appreciate their assistance. In particular, we would like to thank Samuel Houngué with the Library Research and Reference Service, who was an ongoing source of support for the Committee on Public Finance, sharing the results of his research on the matter, preparing documents and helping write this report. We would also like to thank Danielle Simard for her careful copyediting of the documents. In addition, we offer our sincerest thanks to Committee clerks Cédric Drouin and Mathew Lagacé and secretary Simon Quer for their dedication and efficiency in organizing this self-initiated order and seeing it through to successful completion.

Lastly, we would be remiss not to thank tax expert Brigitte Alepin—one of the first to discuss this topic with us—and the individuals and groups that attended the public hearings. We are grateful for their invaluable contribution to the discussion and to the recommendations in this report. We hope these recommendations will draw the attention of governments and spur them to take concrete action to counter tax evasion and avoidance.

Raymond Bernier
Member for Montmorency
Committee Chair

Nicolas Marceau
Member for Rousseau
Committee Vice-chair

André Spénard
Member for Beauce-Nord
Committee Vice-chair

OVERVIEW

ORDER

On February 25, 2015, the Committee on Public Finance launched a self-initiated order entitled "Use of tax havens for the purposes of tax evasion and avoidance." The purpose of the order was to assess the scope of the phenomenon in Québec and propose countermeasures.

Members read up on the issue and took part in special activities. The Committee also heard 22 groups and individuals at special consultations and public hearings. The Committee pursued a solutions-driven approach to the public hearings. This report does likewise. The report contains 27 recommendations for measures to be implemented by the Québec government and 11 others whose potential application should be discussed with the federal government.

THE ROLE OF TAX HAVENS

The 2008 financial crisis made it clear that tax havens play a pivotal role in tax evasion and avoidance and do so on an international scale. The actual number of tax havens varies according to which source one consults. None of the world's governments, Québec and Canada included, are able to accurately estimate tax losses stemming from the use of tax havens. This is largely due to the shroud of secrecy surrounding operations in these jurisdictions and a lack of precise, reliable calculation methods. Some have estimated these losses at between $8 and $15 billion in Canada and $1 to $2 billion in Québec. Others believe these numbers are grossly underestimated.

THE OECD'S FIGHT AGAINST TAX HAVENS

Internationally, the Organisation for Economic Co-operation and Development (OECD) is the group responsible for recommending ways to standardize international tax rules to aid in the fight against tax havens. Since the mid-1990s, the OECD has periodically issued guidelines on transfer pricing, i.e., the prices at which associated enterprises trade goods and services, which can generate tax distortions. The OECD also has standards on tax information sharing among countries. It used to be that data was exchanged only when a partner country requested, but now the practice has become automatic among participating governments. In 2015 the OECD adopted a plan to fight base erosion and profit shifting (BEPS). The plan consists of 15 actions to reform international tax regimes in a coordinated, consistent manner, with the specific goal of countering tax evasion. The world's countries have been asked to implement these actions as quickly as possible.

THE FIGHT AGAINST TAX HAVENS IN CANADA AND QUÉBEC

Canada has had anti-tax haven measures in place since the mid-1980s. The most recent were implemented in March 2016. The 2016–2017 federal budget proposes international tax measures and increases the Canada Revenue Agency's budget. Ten of 15 BEPS actions address international taxation issues. Internally, the Canada Revenue Agency was granted an additional $444 million over five years to hire more auditors and develop a solid information technology infrastructure.

For its part, Québec has had measures to combat abusive tax planning (ATP) since 2009. Under a framework agreement with its federal counterpart, Revenu Québec receives information collected under tax treaties and tax information exchange agreements Canada has signed with other countries. In its last two budgets, the Québec government indicated it intends to ramp up discussions with the governments of Canada and other provinces to more effectively combat international tax evasion and avoidance.

THE FIGHT AGAINST TAX HAVENS IN OTHER COUNTRIES

A number of other countries have implemented anti-abusive tax avoidance and tax haven measures similar to those in Canada, including Germany, the United States, France, Portugal and the United Kingdom. Between January and April 2016, the European Union adopted a number of guidelines on implementing specific BEPS actions similar to those in Canada.

The U.S. passed the Foreign Account Tax Compliance Act (FATCA) in 2014. This law requires that foreign financial institutions report the information they have on their U.S. clients to the U.S. Internal Revenue Service, or be subject to penalties. The U.S. subsequently signed intergovernmental agreements with certain countries, including Canada. These agreements impose the same requirement on U.S. banks and served as a model for the automatic exchange of information standards developed by the OECD.

Beginning in 2014, countries such as Australia, Denmark, Norway, the Netherlands and the United Kingdom implemented central registers to curb the use of anonymous shell companies—dummy corporations used by large businesses to develop complex schemes to transfer funds to tax havens. Central registers track the owner(s) and ultimate beneficiaries of these companies.

COMMITTEE ON PUBLIC FINANCE HEARINGS

The Committee on Public Finance heard 22 witnesses in public hearings. Banks and accounting firms maintained there are no more tax havens, only low tax jurisdictions. They also claimed that the government's tax shortfalls are due to tax evasion, not tax avoidance, which is a legal practice. According to all other witnesses, abusive offshore tax avoidance schemes are all too real and are to blame for a significant portion of lost government revenues. Some witnesses maintained that stemming their use will require standardizing international tax rules and implementing the OECD's recommendations. Others called on the Québec government to withdraw from Canadian tax treaties and to tax multinationals on their operations in Québec. Some witnesses asked that public contracts be awarded only to businesses that can demonstrate they are not active in tax havens.

A number said that new regulations are unnecessary unless they are to replace incomes taxes with withholdings more appropriate for the global economy. Higher sales taxes and e-commerce taxes were mentioned in this regard. Most witnesses also asked National Assembly members to earmark additional resources for Revenu Québec so it can perform more audits and process voluntary disclosures more quickly.

THE COMMITTEE'S OBSERVATIONS AND RECOMMENDATIONS

Committee members dispute what the banks and accounting firms maintain about tax havens and their impact on government revenues. They recognize the complexity of the issue and challenges inherent in combatting it effectively. They have made note of the measures in place in Québec since 2009 and the comments and suggestions by witnesses at the public hearings.

They also acknowledge the recent measures in the federal budget and the provisions implemented by the European Union and other countries. In that light, they have drawn up two sets of recommendations for the Quebec government: one to be implemented by the provincial government itself and another to be discussed with the federal government for potential implementation at the national level.

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FOREWORD

On February 25, 2015, under Section 149 of the Standing Orders of the National Assembly, the Committee on Public Finance agreed to initiate an order to explore the use of tax havens for the purposes of tax evasion and avoidance. Since the early 2000s, the use of tax havens by individuals and corporations has been a topic of discussion widely covered in global news reports, and has even led to public inquiries in countries such as the United Kingdom, France and the United States. The Committee therefore sought to assess the scope of the phenomenon in Québec and investigate ways to combat it. The primary goal of the self-initiated order was to help National Assembly members and the general public understand tax havens and analyze how they are used.

To that end, elected officials decided to look at the impact of tax havens on Québec's tax revenues and identify measures in place at Revenu Québec, the Canada Revenue Agency and in other administrations. The Committee took it upon itself to recommend potential solutions to counter the phenomenon.

To define the scope of the work and avoid pointing fingers, Committee members agreed on a few points. First, they decided to look only at gaining a proper understanding of the strategies and mechanisms in question. Second, they opted to present the issue without targeting specific parties that facilitate or benefit from the use of tax havens.

To carry out this order, the Committee also held individual consultations and public hearings attended by the 22 groups shown in the table below.

Revenu Québec	Royal Bank of Canada	KPMG	Alain Deneault
Ministère des Finances du Québec	Scotiabank	Pricewaterhouse Coopers	
Éric Lauzon	TD Canada Trust	Deloitte	
Paul Ryan	Bank of Montreal	Ernst & Young	
Autorité des marchés financiers	Desjardins Group	Marwah Rizqy	
Canadian Bankers Association	Julien Frédéric Martin	André Lareau	
National Bank of Canada	Raymond Chabot Grant Thornton	ATTAC-Québec	

The Committee carefully reviewed various briefs submitted by witnesses. Members watched the film *Le prix à payer* cowritten by tax expert Brigitte Alepin. Some members attended the TaxCOOP conference organized by Ms. Alepin and held in Montréal on November 3, 2015. Others went on a mission to visit European and French institutions in Brussels and Paris from February 13 to 19, 2016. Committee members also read reports on tax havens by the U.S. Senate Permanent Subcommittee on Investigations.[1] They received and carefully reviewed responses from the Canada Revenue Agency to questions they had submitted for clarification.

All of these activities and documents informed the Committee's work. Six days of hearings were held between September 2015 and September 2016.

1 The reports by the U.S. Senate Permanent Subcommittee on Investigations include *Caterpillar's Offshore* Tax Strategy (April 1, 2014), *Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts* (February 26, 2014) and *Dividend Tax Abuse: How Offshore Entities Dodge Taxes on U.S. Stock Dividends* (September 11, 2008) at http://www.hsgac.senate.gov/subcommittees/investigations.

INTRODUCTION

As part of the self-initiated order by the Committee on Public Finance on the use of tax havens for the purposes of tax evasion and avoidance, the Committee held public hearings on September 30, 2015, November 17 and 18, 2015, May 12 and 19, 2016, and September 15, 2016, for groups interested in tax havens in some way or to some degree. The Committee heard 22 groups, associations and individuals.

The Committee would first like to thank everyone who took part in the hearings for their briefs, presentations, input and proposals, which helped the Committee better understand tax havens and existing and potential measures to mitigate their impact, if not eradicate them altogether.

The Committee took a solutions-driven approach from the time the self-initiated order was adopted in February 2015, all throughout the public hearings process and in this report to the National Assembly. The report includes recommendations the Committee believes will be instrumental in effectively combating the use of tax havens in Québec and Canada. Some suggestions are aimed at the Québec government directly and could be implemented in short order. Others fall under federal jurisdiction and will need to be discussed with the Government of Canada. Many of these recommendations are based on measures in place in other countries and supplement the international tax measures announced by the federal government in its 2016–2017 budget.

The report is divided into three parts. The first provides an overview of tax havens, their significance in Québec, Canada and the world, and related initiatives by the Organisation for Economic Co-operation and Development (OECD). It also summarizes key anti-tax evasion measures implemented over the years in Québec, Canada and several other countries. Part Two presents the Committee's work on the issue. Part Three presents the Committee's observations, conclusions and recommendations.

PART ONE

TAX HAVENS

TAX EVASION AND AVOIDANCE AND TAX HAVENS

In Québec, tax evasion is the act of failing to report revenue from secret foreign activities or investments. Tax avoidance is the use of existing tax rules to reduce or eliminate taxes owed.[2] Taken to the extreme, avoidance becomes abusive tax avoidance.[3]

Tax holidays and bank secrecy pave the way for tax evasion, and competition among countries to offer increasingly tempting tax loopholes fosters abusive tax planning.

Generally speaking, profits that individuals and corporations generate from tax evasion or tax avoidance are sheltered from taxes in foreign countries—known as tax havens.

The OECD defines a tax haven as a jurisdiction meeting one or more of the following four criteria:

- No or nominal tax
- Existence of bank secrecy protected by stringent provisions
- Lack of transparency in the tax system
- Lack of effective exchange of information with other countries

The 2008 economic and financial crisis made clearer the role of tax havens in tax evasion and abusive tax avoidance around the world. Their role has intensified and accelerated due to globalization and the Internet on the one hand and the misuse of tactics such as tax treaties and transfer pricing on the other.

THE SIGNIFICANCE OF THE WORLD'S TAX HAVENS

There is no consensus on exactly how many tax havens exist in the world—the number varies depending on the source. The most recent list, compiled in 2015 by the U.S. Congressional Research Service (CRS), identifies 50 tax havens.[4]

The CRS also identifies nine countries, Canada being one, having tax haven characteristics while not making the formal list.[5] In 2010 Forbes magazine published a list of the top ten tax havens in the world based on the amount of money moving through them.[6]

According to the International Monetary Fund (IMF), 50% of the world's capital passes through tax havens. They shelter some 4,000 banks, two-thirds of hedge funds[7] and two million shell companies.[8] Tax havens reportedly harbour $21 trillion to $31 trillion[9] and cause $3.1 trillion in lost tax revenue to governments worldwide.

2 In Europe, tax evasion according to the Québec definition is called "tax fraud" and tax avoidance as defined in Québec is called "tax evasion."
3 Some tax avoidance tactics are legal, such as deducting business losses from income or carrying forward losses incurred in a previous year. They differ from abusive tax avoidance manoeuvres, e.g., tax avoidance through the use of tax havens. The term "abusive tax planning" (ATP) was used in Québec in the past. But ATP was not specifically associated with the use of tax havens. For that reason, the Committee decided to use "abusive tax avoidance" to avoid confusion in this report.
4 The list is included in Appendix I. See: Congressional Research Service, *Tax Havens: International Tax Avoidance and Evasion*, January 15, 2015.
5 The list of nine countries is shown in Appendix II.
6 This list—still the most widely cited by the media—is presented in descending order of importance in Appendix III. See "World's Best Tax Havens," *Forbes* http://www.forbes.com/2010/07/06.
7 Hedge funds are investment funds not open to the public and managed in a way not tied to the stock market that use speculative techniques to take advantage of highs and lows in various markets.
8 A shell company is a dummy corporation created to conceal the financial transactions of one or more other corporations. There are a number of reasons to set up a shell company, including tax evasion and money laundering.
9 http://www.cadtm.org/L-existence-des-paradis-fiscaux-n, accessed in August 2016.

THE SIGNIFICANCE OF TAX HAVENS IN CANADA AND QUÉBEC

According to Statistics Canada, Canadian taxpayers parked some $300 billion in tax havens in 2014. The stock of Canadian direct investment in seven offshore tax havens in 2014 was more than $184 billion,[10] representing 54% of all foreign direct investment assets in the Canadian financial sector and 22.2% of Canada's total foreign direct investments. That same year, Barbados became the second most popular foreign direct investment destination after the United States.[11] In 2015 corporate tax haven spending increased 17% over the year before. Combined, the big five Canadian banks operate over 81 subsidiaries in tax havens.

According to Institut de recherche en économie contemporaine (IREC), the use of tax havens is costing Canada an estimated $8 billion to $15 billion a year in lost tax revenue.[12]

In Québec, the use of tax havens is considered synonymous with tax evasion. As part of the special consultations held for this report, the Ministère des Finances estimated Québec's annual taxes lost to tax havens at $0.8 billion to $1 billion.[13] IREC, on the other hand, pegs Québec's losses from tax havens at $1 billion to $2 billion. By many estimates, the figure is even higher.

OECD TAX HAVEN INITIATIVES

At the international level, the OECD is the organization mandated by the G20 and G8 to encourage and support countries in their anti-tax haven measures. The OECD has been working with and guiding countries in the fight since the mid-1990s, but it has become more active since the 2008 economic and financial crisis. Key actions taken by the OECD thus far have been to:

- Set out and guide the application of the arm's length principle in transfer pricing
- Adopt and disseminate standards governing the exchange of information on request and the automatic exchange of information
- Adopt a base erosion and profit-shifting (BEPS) action plan

Transfer pricing refers to the prices at which divisions of a multinational trade goods and services with each other. Transfer prices therefore determine how profits are divided up between these entities and, as a result, how much each entity and the group as a whole pay in taxes. To prevent groups from setting arbitrary prices to lessen their tax burden, the OECD recommends applying the arm's length principle and using the market price as the transfer price. The market price is the price at which a comparable transaction would have been carried out if it had taken place between two unaffiliated entities.

The OECD released its first standard governing the exchange of tax information between countries in 2009. Exchanges of information were to be made at one party's request, be exempt from restrictions and uphold taxpayer rights. Information exchanged was also to be kept confidential.

On May 6, 2014, the OECD introduced a new exchange standard that would be automatic instead of on request. The automatic exchange of information requires financial institutions active in partner jurisdictions[14] to identify clients with residency in another partner country. Once a reportable person has been identified, the financial institution must report the required information annually to the local tax authorities, which will then transmit the information to the tax authorities in the country in which the individual has tax residency.

10 Institut de recherche en économie contemporaine, *La fuite vers les paradis fiscaux a connu une croissance phénoménale*, Fiche technique n° 2, October 2015, http://www.irec.net/upload/File/ftc2015_10_14paradisfiscaux.pdf.
11 Statistics Canada, "Foreign direct investment, 2014," *The Daily*, April 24, 2015.
12 IREC, *op. cit*.
13 Ministère des Finances, *Le phénomène du recours aux paradis fiscaux*, Brief submitted to the Committee on Public Finance, September 29, 2015, http:/www.finances.gouv.qc.ca/documents/Autres/fr/AUTFR_memoireparadisfiscaux.pdf.
14 Partner jurisdictions are countries signatory to the automatic exchange of information agreement.

Under the standard, tax havens must participate in the automatic exchange mechanism in order to access the international financial market.

In December 2015, over 100 countries, including Switzerland and other major hubs, committed to implementing the new standard. Nearly half of these jurisdictions plan to make the first automatic exchanges in 2017, with the remainder (Canada included) following in 2018.

In another move, the OECD launched the base erosion and profit-shifting (BEPS) action plan in 2013. BEPS is a set of recommendations set forth by the OECD as part of a coordinated international approach to counter tax evasion by multinationals. The 15 BEPS actions aim to be a single set of international tax rules to prevent the erosion of tax bases and the artificial shifting of profits to specific countries or jurisdictions in an effort to dodge taxes. The actions are intended to be a global, coordinated approach to international tax reform. In October 2015 after finalizing the BEPS framework, the OECD called on countries to implement the anti-tax evasion and avoidance actions as quickly as possible.

THE FIGHT AGAINST TAX HAVENS IN CANADA AND QUÉBEC

The Fight in Canada

Like most industrialized countries, Canada has implemented a range of mechanisms to curb the use of tax havens over the years.[15] Most recently, the 2016–2017 federal budget included anti-abusive tax planning provisions meeting certain BEPS recommendations and touching on:

- Transfer pricing documentation and country-by-country reporting[16]
- Guidelines on setting transfer prices[17]
- Tax treaty abuse[18]
- Spontaneous exchange of tax rulings with other tax authorities[19]
- Development of a multilateral instrument to amend tax treaties
- Amendment of the exception to the anti-surplus-stripping rule[20]
- Expansion of the scope of existing back-to-back loan rules to four other situations: rents and royalties, character substitution rules, shareholder loans and multiple intermediary structures[21]

The budget measures cover 10 of the 15 BEPS actions. The federal government has indicated it will continue investigating recommendations on the remaining five actions.

The 2016–2017 budget also includes a $444.4 million investment over five years to help the Canada Revenue Agency crack down on tax evasion and avoidance. The funds will be used to hire more auditors and build up the information technology infrastructure.

On April 11, 2016, the minister of the Canada Revenue Agency announced details on how the allocated funds will be spent. She also announced the creation of an independent advisory committee to investigate existing and future offshore tax evasion tactics and strategies to combat them. She released a Canada Revenue Agency study indicating that the scope of overseas tax evasion is difficult to estimate and that, like other countries, Canada is not able to accurately calculate the tax gap in the short or medium term.[22]

15 Key measures implemented before the 2016 budget are listed in Appendix IV.
16 This point is explained in Appendix V.
17 This point is explained in Appendix VI.
18 This point is explained in Appendix VII.
19 This point is explained in Appendix VIII.
20 This point is explained in Appendix IX.
21 This point is explained in Appendix X.
22 According to the study, Sweden is the only country to have attempted to estimate the tax gap, but there were so many underlying assumptions that even the Swedish government noted the estimate had a high degree of uncertainty.

The Fight in Québec

In 2009 Québec adopted anti-abusive tax avoidance measures to counter interprovincial and international tax schemes.[23]

Revenu Québec also signed a framework agreement with the Canada Revenue Agency giving it access to information collected by virtue of tax treaties and information exchange agreements Canada has concluded with certain countries.[24]

Moreover, in the March 2015 and March 2016 budget speeches, the Québec government indicated plans to ramp up discussions with the federal and provincial governments to effectively stem tax evasion and abusive tax avoidance.

The Fight in Other Countries

A number of other countries, including the United States, the United Kingdom, Portugal, Germany and France, have implemented measures similar to those in place in Canada to fight abusive tax avoidance and tax havens.

Among them, the U.S. has the most innovative measures, strictest provisions and highest penalties—for the user, 30% of the dodged taxes or $200,000, whichever is greater, and for the promoter, 50% of the profit made from abusive tax planning or $200,000, whichever is greater. *The Foreign Account Tax Compliance Act* (*FATCA*) came into effect in 2014, requiring foreign banks to report on their U.S. clients or entities subject to U.S. taxation. Financial institutions that fail to comply are subject to a 30% withholding tax on their U.S. activities.

After *FATCA* was enacted, the U.S. signed intergovernmental agreements with a number of countries. These agreements set out the procedures for implementing *FATCA* and ensure reciprocity of tax information–sharing by U.S. banks on citizens from signatory countries.

Germany, Spain, the United States, France, Italy and the United Kingdom developed a model for applying *FATCA* between signatory governments. The OECD also developed a broader automatic exchange model based on *FATCA* and intergovernmental agreements to be applied in non-signatory countries—an initiative known as *FATCA* International.

Beginning in 2014, countries such as Australia, Denmark, Norway, the Netherlands and the United Kingdom implemented central registers to curb the use of anonymous shell companies—dummy corporations used by large businesses to develop complex ways to transfer funds to tax havens. Central registers track the ultimate beneficial owner(s) of these companies. Without the cover of anonymity, it becomes more difficult for them to violate existing tax rules.

On January 28, 2016, the European Union presented the Anti Tax Avoidance Package containing proposals on adopting a common tax base, putting together a blacklist of uncooperative tax havens, interest and royalty deductibility, harmful tax practices, stable institutions, misuse of tax treaties, setting and documenting transfer prices and country-by-country reporting.

23 Appendix XI presents provincial corporate tax rates effective January 1, 2016, and Appendix XII describes key anti-abusive tax planning measures.
24 Québec signed a tax treaty with France—the Tax agreement between the Gouvernement du Québec and the Gouvernement de la République française—providing for the exchange of information between the two governments.

On April 12, 2016, the European Commission issued a new directive[25] requiring any company operating in the European Union with global revenues of at least 750 million euros[26] to publish a country-by-country report, to be made public.

The table below presents certain measures in place in the jurisdictions examined.

MEASURES	JURISDICTIONS IN WHICH THEY APPLY
Signing or modification of tax treaties	Germany, Canada, France, Portugal, United Kingdom, European Union
Information exchange agreements	Germany, Canada, France, Portugal, United Kingdom, European Union
Voluntary disclosure of hidden abusive tax planning information	Canada, France, United Kingdom
Mandatory disclosure of information on abusive tax planning schemes	Canada, United States, France, Québec
General anti-avoidance rule (makes a transaction illegal)	Germany, Canada, Québec, United Kingdom
Penalty on abusive tax planning scheme users	United States, Portugal, Québec
Penalty on abusive tax planning scheme promoters	Canada, Portugal, Québec, United Kingdom
Mandatory disclosure of potentially abusive tax shelters	United States, France, Portugal, Québec, United Kingdom
Restrictions to interest and royalty deductions (thin-capitalization rules)	Germany, Canada, France, Portugal, European Union
Suspension of certain tax advantages when tax havens are involved	Germany, Canada, France, Portugal, United Kingdom
Identical rules for national and international subsidiaries	United States, European Union
Specific provisions for certain trusts	Canada, Québec
Country-by-country reporting	As of December 31, 2016, over 40 countries, including Germany, Australia, Canada[27], China, Denmark, France, India, Japan, Norway, Switzerland and the European Union member states
Setting and documenting transfer prices	Canada, European Union
Central register of ultimate beneficiaries	Australia, Denmark, Norway, Netherlands, United Kingdom, European Union

25 In the European Union, a directive is a legal act of the European Council or Commission requiring member states to achieve a particular result.
26 Companies without a subsidiary in the European Union must publish the same data, but for their global operations, and provide more detailed information on their activities in tax havens.
27 On July 29, 2016, the federal government released draft legislation for public comment that would introduce country-by-country reporting requirements. The document maintains the €750 million threshold and establishes penalties for fraud or failure to file. It also refers to a prescribed form for filing, although this has yet to be released. The government is committed to protecting the confidentiality of reports filed.

PART TWO

THE COMMITTEE'S WORK

EUROPEAN MISSION

From February 13 to 19, 2016, Committee members went on a fact-finding mission, visiting European and French institutions in Brussels and Paris to see how their European counterparts were handling the tax haven issue. They learned about European Commission directives recently issued to member states: one on country-by-country reporting and the exchange of information between tax authorities, one on member states' obligation to adopt corrective measures at the national level to discourage the most common tax avoidance practices and one on the Common Consolidated Corporate Tax Base. Under the Common Consolidated directive, companies can use one point of single contact system to file their tax returns and consolidate profits and losses across the European Union. The tax authority in the reporting company's place of residence will share any tax profits with the member states based on the company's footprint in each state.

Members of the Québec mission also learned more about the proposals by Plateforme Paradis Fiscaux et Judiciaires, a group of 19 French civil society organizations. The proposals include granting company employees the individual right to sue their employers if they are forced to collaborate in tax avoidance schemes, setting a minimum corporate tax rate for all countries, developing a public register of trusts and shell companies that tracks actual owners and requiring tax advisors to disclose their clients' tax planning arrangements to the tax authorities according to set criteria.

Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration, also shared his perspective on key points, such as the automatic exchange of information, amendments to tax treaties, transfer pricing, the participation of developing countries and the role of legislators.

In addition, mission members explored tax avoidance issues specific to France and measures implemented in recent years by the National Assembly Foreign Affairs Committee, the Senate Finance Committee, the 2012 and 2013 Senate inquiry committees and Tracfin (Traitement du renseignement et action contre les circuits financiers clandestins).

SPECIAL CONSULTATIONS AND PUBLIC HEARINGS

The Committee on Public Finance received eight briefs and heard 22 witnesses in special consultations and public hearings. Committee members felt it was important to hear from public, private and institutional stakeholders. They learned much about tax havens over the six days of consultations, as summarized below.

SEPTEMBER 30, 2015

The witnesses that appeared during the first day of hearings were Revenu Québec, Québec's Ministère des Finances, Éric Lauzon and Paul Ryan.

Revenu Québec

Revenu Québec acknowledged that there were legal mechanisms taxpayers could use to reduce their tax burden, making abusive tax avoidance all the more difficult to prove. It was the agency's opinion that abusive tax avoidance could only be stemmed through information sharing, not more regulation.

The agency stated that it relied on a database and a register of businesses. Trusts operating a commercial enterprise in Québec have been required to join the register since July 1, 2014. Revenu Québec also said it used data from tax evasion accusations and public disclosure, such as the scandals revealed by the International Consortium of Investigative Journalists in February 2015. As a result of these revelations, the agency was able to recover more than $31 million plus an additional $52 million from subsequent voluntary disclosures.

Revenu Québec claimed that the increase in voluntary disclosures in Québec in recent years could largely be chalked up to OECD actions and *FATCA*. It explained that voluntary disclosures in Québec were primarily made by individuals. By the agency's estimate, the number of voluntary disclosures went from 588 in 2013 to 1,538 as of August 31, 2015,[28] and the funds recovered rose from $79 million in 2013 to $387 million as of August 31, 2015.[29]

The agency also expressed concern over an estimated $137 million in annual tax losses associated with e-commerce outside Canada and a failure to collect taxes at border crossings.

Nevertheless, Revenu Québec said it remained optimistic about the OECD's anti-base erosion and profit-shifting initiatives and that it planned to follow OECD recommendations on handling offshore trusts operating businesses in given jurisdictions.[30]

Revenu Québec indicated it had the resources it needed to carry out its mission to combat tax havens and abusive tax planning. The agency also said it was working closely with the Ministère des Finances to amend tax policies aimed at countering tax havens, abusive tax planning and tax evasion.

At the federal level, the Québec agency stated it was also satisfied with how information was being exchanged with its federal counterpart.

Ministère des Finances du Québec

The Ministère des Finances du Québec stated that in 2014–2015, $58.9 billion of the government's $96 billion in consolidated revenue (61.4%) came from taxes. It was the ministry's opinion that the gradual erosion of Québec's tax base was not a factor because Québec was able to collect much of what taxpayers owed under applicable laws and regulations. According to the ministry, Québec lost tax dollars in four ways: failure to declare legal income, concealment of illegal income, failure to comply with tax rules and tax avoidance. The ministry claimed that tax havens enabled and facilitated tax avoidance strategies or provided a tax shelter for tax evasion profits.

According to ministry estimates, Québec loses $800 million in taxes from the use of tax havens and abusive tax avoidance manoeuvres by households.[31] Businesses' tax avoidance tactics account for another $200 million in lost tax dollars.[32] The ministry felt that for Québec to be successful in its fight against international tax evasion and avoidance, it must join in national and international initiatives.

28 According to Radio-Canada data, this number was 500 in 2011–2012, 648 in 2012–2013, 599 in 2013–2014, 651 in 2014–2015 and 934 in 2015–2016, so agency data is annual.

29 Unlike the United States, which imposes penalties of 5%, 12.5% or 27.5% on amounts held over the previous eight years, Canada and Québec impose no limits. And unlike Canada, which counts capital accumulated over the previous ten years, Québec does not set a time limit on capital accumulation, but it does charge interest on amounts due.

30 With respect to trusts, representatives mentioned the use of a number of products (e.g., Finco, Q-Yes plan, Shuffle) designed by tax professionals to contort existing tax provisions for abusive tax avoidance purposes—for instance, using different year-end dates for provincial and federal tax authorities for the same trust or setting up a trust outside the province where it earns income (to shelter this income from taxes). The courts have heard a number of these cases, siding with taxpayers at times and tax authorities at others. According to the Ministère des Finances, this showed there were still tax law loopholes to be exploited and the General Anti-Avoidance Rule could be hard to enforce.

31 This estimate is based on a 2014 study by Gabriel Zucman on global wealth held in the world's financial centres. Canadian individual taxpayers' share of capital accumulated outside Canada was estimated at $300 billion, or 9% of Canadians' total financial assets. The ministry calculates the amount of annual tax losses by determining the share of wealth of Quebecers with an annual income of $150,000 and up (representing 15.6% of all Canadians in that income bracket) in all Canadian wealth.

32 This figure was determined by extrapolating on a preliminary International Monetary Fund study that estimated global corporate tax revenue losses at 5%.

The ministry also stressed the importance of the OECD's automatic information exchange initiative and the multilateral instrument to modify tax treaties.

The ministry indicated that a number of anti-tax evasion and avoidance actions had been implemented. For instance, the government reviewed its legislative framework in 2009 to incorporate measures to counter abusive tax avoidance. Revenu Québec formed a team to specifically look at tax planning files that could involve tax havens. From its inception to 2015, the team helped recoup over $516.6 million.

For Québec's fight against tax havens, the government used various tools at its disposal to support and assist the federal government. Québec also closely followed the OECD's work on the issue, including base erosion and profit-shifting countermeasures, international tax information transparency and exchange standards, the Multilateral Competent Authority Agreement for the Common Reporting Standard, and Guidance on Transfer Pricing Documentation and Country-by-Country Reporting. The federal government had been involved in a number of these actions and agreements. The ministry said that Québec was willing to adapt its tax regime according to OECD actions and guidelines by aligning its tax rules with federal rules.

The ministry recommended that the federal and Québec governments implement the OECD measures quickly. But first and foremost, the ministry urged the Quebec government to keep up the fight against internal tax evasion by companies and individuals because, in its opinion, declared and taxed income was not usually moved through tax havens.

On the possibility of developing an informant award program like the federal government's, the ministry recommended waiting for an assessment of the federal program. The ministry insisted that any informant award program must be clearly defined to avoid misuse and overuse.

Lastly, the Ministère des Finances du Québec noted that it was working closely with its federal counterpart and that the two agencies exchanged information on a continuous basis.

Éric Lauzon

Éric Lauzon said he worked at Geneva bank Ferrier Lullin[33] for several years and witnessed Swiss bank involvement in tax havens during his time there. Since returning to Québec in 2009, he had been raising awareness on the issue and helped create the organization Échec aux Paradis Fiscaux.

According to the witness, 95% of funds moving through tax havens belonged to institutions and 5% to individuals, so successfully fighting international tax evasion and avoidance would require tighter regulation of businesses, and banks in particular since they were the top users of tax havens.

Mr. Lauzon held that Canadian companies paid too little in taxes. He maintained that the OECD's automatic exchange of information would not be very effective because information would not be verified. On the other hand, he felt country-by-country reporting was worthwhile and would be easy to apply legislatively.

Mr. Lauzon also stated that Québec's independence would allow it to act in areas where the federal government had not. Québec could work directly with international anti-tax haven groups without waiting for the federal government to make a move. He recommended that Québec look to France for inspiration, where lending institutions were prohibited from using tax havens and required to take steps to counter fraud and money laundering.[34] He also recommended a more effective policy to directly target professionals who promoted the use of tax havens—tax specialists, legal experts and accountants in particular.

33 This 211-year-old private bank was purchased by a larger bank, Julius Bär, in September 2005.
34 These regional initiatives were subsequently recognized by the French National Assembly, which adopted a banking law based on them. Sweden and Finland are reportedly in the process of implementing similar models.

Paul Ryan

Paul Ryan manages a law firm of 20 attorneys specializing in tax litigation. The firm provides voluntary disclosure assistance and other services to taxpayers, many of whom are small business owners.

In Mr. Ryan's experience, given the increase in voluntary disclosures, international efforts to fight tax havens were already yielding positive results. His law firm helped some 300 clients file $300 million in voluntary disclosures over a short span of time. He noted that fewer and fewer clients were opening accounts in tax havens—a result, in his opinion, of *FATCA* and the automatic exchange of information initiative in which Canada would participate starting in 2018. Mr. Ryan urged the provincial and federal governments to earmark more money for quicker processing of voluntary disclosures. It was his view that the current 12- to 18-month turnaround time was too long.

Mr. Ryan then addressed the issue of tax avoidance by non-resident trusts.[35] He pointed out that in 2007 the federal government amended the *Income Tax Act* to tax these entities' income. He expressed surprise that Québec still had not passed similar legislation despite an announcement a few years back that it intended to follow suit. Without offering an opinion, Mr. Ryan pointed out that the constitutionality of such a law could be called into question. The federal government had jurisdiction over direct and indirect taxes but Québec only had direct taxation authority and the taxation of a resident trust could be considered indirect taxation.

The witness also urged the federal and provincial governments to more tightly regulate subsidies and tax credits for research and development. According to Mr. Ryan, these grants were used to create intellectual property rights that were then routed to tax havens.

NOVEMBER 17, 2015

The witnesses on the second day of hearings were Autorité des marchés financiers, the Canadian Bankers Association and five chartered banks.

Autorité des marchés financiers

Autorité des marchés financiers (AMF) noted that it did not have jurisdiction over tax audits but that it was working closely with tax authorities and the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC).[36] AMF shared information on suspected tax evasion and money laundering with these groups, which then evaluated each case on its merit and took the appropriate steps.

AMF pointed out, however, that its ability to provide taxpayer information to competent authorities was strictly regulated here in Québec by the *Act respecting the protection of personal information in the private sector* and by confidentiality clauses in agreements with the International Organization of Securities Commissions.

In response to Committee member questions, AMF said it felt it was already proactive and effective in exchanging information with tax authorities, and the government did not need to give it additional authority in fighting tax havens. It noted, however, that it was not kept informed of how tax authorities and FINTRAC followed up on the information it provided, but did acknowledge that investigations were made public once concluded.

35 An example of a non-resident trust would be if a Québec taxpayer were to open a trust in a foreign country that could potentially be a tax haven for the benefit of Québec residents as well, but the trust were administered by residents from the country in which it was created. This type of trust was deemed non-resident because the trust's place of residence was determined by the trustees' place of residence.

36 The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) was Canada's financial intelligence unit. Its mandate was to facilitate the detection, prevention and deterrence of money laundering and the financing of terrorist activities, while ensuring the protection of personal information under its control.

AMF does not track statistics on businesses that are refused the right to contract because of tax haven–related activities under the *Act respecting contracting by public bodies*. Tax audits are performed by the anti-corruption unit (UPAC), not Autorité des marchés financiers. AMF also does not track statistics on financial planning firms, brokers or advisors whose licences have been restricted or suspended due to tax haven–related activity.

With respect to operating licences, AMF recommended doing away with the many grey areas in tax regulations before considering suspending business certifications. In the existing legislative framework, it was not always easy to differentiate between illegal or abusive practices and legal ones.

Canadian Bankers Association

The Canadian Bankers Association represents 60 Canadian and foreign financial institutions employing some 45,000 Quebecers.

Representatives prefaced their remarks by saying that association members never advised clients to resort to tax evasion in Canada or anywhere else. They also noted that they consistently sent information on chartered bank activities to the Canadian tax authorities as required.

The association then flatly refused to address Assembly members' questions about such cases as the Royal Bank of Canada[37] and Arthur Porter.[38] Representatives claimed that they could not comment on specific cases. When Committee members asked for figures on funds transfers from suspicious activities to tax havens by Québec taxpayers, the witnesses advised them to direct their question to FINTRAC. Members were also unable to learn anything more about what happened when, as the witnesses stated, a bank closed an account it suspected was connected to a tax haven.

Banks

The five banks heard were National Bank of Canada, Royal Bank of Canada, Scotiabank, TD Bank Group and Bank of Montreal. The banks' answers to Committee members' questions were very similar, so they have been compiled for this report.

According to the banks, there were no tax havens anymore, only low tax jurisdictions, in which almost all had branches. National Bank of Canada reported it had closed its two branches in Nassau and Geneva because the two centres were not doing enough business to be profitable. That said, it was impossible to discern if the bank branches were complicit in Canadian taxpayers' use of tax havens. All the banks claimed their reputations were too important to risk helping taxpayers practice tax evasion or abusive tax avoidance. They maintained that their international operations strictly complied with tax legislation in Canada and the host countries. In their opinion, Canadian banks were already more strictly regulated than other institutions. They felt that cooperation among countries—through the exchange of information in particular—was the best way to fight tax evasion and avoidance. But they expressed reservations about country-by-country reporting. The banks stated that the OECD recommendation would unnecessarily increase the information required from businesses, which carried a large enough reporting burden as it was.

37 In December 2014 Royal Bank of Canada was required to pay $35 million to the Commodity Futures Trading Commission (CFTC) for developing a fictitious derivatives sales system with offshore branches in Luxembourg, the Bahamas and the Cayman Islands to lower its tax bill. CFTC is an independent agency of the US government created in 1975 that regulates commodity exchanges where raw materials are traded.

38 Arthur Porter was allegedly involved in a $22.5 million kickback scheme by SNC-Lavalin to land the McGill University Health Centre (MUHC) construction contract. Mr. Porter was MUHC's CEO when the request for proposals was issued and was reportedly SNC-Lavalin's point man. He subsequently moved to the Bahamas, investing in a number of tax havens.

NOVEMBER 18, 2015

Two witnesses were heard on this day: Desjardins Group and Julien Frédéric Martin, a professor at Université du Québec à Montréal.

Desjardins Group

Desjardins Group stated that 99.8% of its $15 billion in annual earnings were made in Canada and that it did not have branches in, send funds to or direct clients to tax havens. According to its spokespeople, brokers had been fired for violating the financial institution's tax haven rules.

Even so, according to Desjardins Group, tax havens could not exist or operate without the complicity of certain financial institutions.

Desjardins Group then explained the methods it used to combat tax evasion, and money laundering in particular. Working with stockbrokers, National Bank of Canada, Laurentian Bank of Canada and Casino de Montréal, it created the Québec chapter of the Association of Certified Anti-Money Laundering Specialists.[39] It also participated in FINTRAC and *FATCA* International, which required Desjardins Group and other Canadian financial institutions to report not only U.S. citizen account holders, but also foreign tax residents.

Representatives then went over the tools Desjardins specialists used to analyze client and member transaction compliance, i.e. watch list filtering, customer due diligence and suspicious activity monitoring. Using these analyses, Desjardins Group made some 7,000 suspicious transaction reports[40] to FINTRAC annually.

It pointed out that, in tax planning, it could be difficult to draw a distinction between legal and illegal transactions. The line between the two could be blurry. According to Desjardins Group, financial institutions were only required to report suspicious transactions and transfers over $10,000 to FINTRAC. They were not expected to make value judgements on or analyze the reasoning behind transactions—only tax authorities had that jurisdiction. Consequently, financial institutions were not required to reject a transaction just because it involved a tax haven.

Desjardins Group felt it was not critical for Québec to adopt new laws or regulations to fight tax havens and that Revenu Québec already had all the tools it needed. But Desjardins urged the provincial and federal governments to implement the OECD's measures. It felt the international organization needed every country's support in fighting the powerful lobbies that would undoubtedly oppose its recommendations.

Desjardins Group then commented on two specific OECD measures. First, it said it supported country-by-country reporting, which they thought would help shed light on transfers of intellectual property to tax havens. A number of businesses—in the IT sector in particular—were using this to generate huge profits in the U.S. and certain European countries, virtually tax-free.

Second, the witnesses stated they did not share some people's concern that *FATCA* International would end up shutting down banks or that banks would refuse to comply. They pointed out that the cost of complying with *FATCA* International—an estimated $100 million—was nothing compared to the cost of noncompliance, which could run over $1 billion. Moreover, the measure applied to all banks, so it would not impact industry competitiveness.

39 The Association of Certified Anti-Money Laundering Specialists (ACAMS) is an international organization dedicated to promoting best practices and advancing knowledge in the fight against money laundering. ACAMS has over 32,000 members worldwide. The Québec chapter is working with ACAMS to make documentation, training tools and the certification program available in French for its members.

40 There is no limit for suspicious transactions—reports can be made on $100 transactions or electronic funds transfers of $10,000 or more (which are required to be reported). Desjardins Group maintained that Autorité des marchés financiers, the Office of the Superintendent of Financial Institutions and FINTRAC periodically audited financial institutions to make sure they were filing reports. The penalties for not complying with reporting requirements were many and costly.

Julien Frédéric Martin

Julien Frédéric Martin is a professor of economics at Université du Québec à Montréal. He came to present the results of a university study on the impact of transfer pricing on French exports. The purpose of the study was to evaluate the scope of the use of tax havens by French multinationals. It was done in collaboration with professors from foreign institutions.

Mr. Martin started by saying that he would not be making a distinction between tax evasion and tax avoidance, given the blurry dividing line between the two. He also warned Assembly members against the tendency to equate tax havens with low and no tax jurisdictions. He noted that the correlation between the two was not one-to-one, citing Luxembourg and Switzerland, two countries with high tax rates that were still considered tax havens.

The witness stated that the gains from analyzing multinational data and using it to draft policies and legislation outweighed the costs. He said he had concerns about the lack of data on Canadian multinationals, which he claimed was largely due to interruptions in the collection and processing of data in recent years. According to Professor Martin, this lack of data fostered tax evasion. It also prevented him from completing his initial project, which was to reproduce Gabriel Zucman's study on the impact of tax havens on U.S. tax losses using Canadian data.

So he set about indirectly measuring the impact on the Canadian economy. One of his findings was that Canada's exported services primarily to the U.S., the United Kingdom, Barbados and Bermuda. Canada imported services from a handful of countries, including Barbados, Bermuda and Ireland. Of these countries, all were tax havens except the U.S. and the U.K. In 2014, 25% of Canada's foreign direct investment was in tax havens, so clearly this was an issue of import to the country.

Mr. Martin then got to the crux of his presentation: his study on the impact of transfer pricing practiced by major French goods manufacturers in 1999. His analysis revealed that only certain locations were being used to offshore profits via transfer pricing—the Bahamas, Bermuda, Cyprus, Hong Kong, Ireland, the Cayman Islands, Luxembourg, Malta, Singapore and Switzerland—all of which were tax havens. France lost

$1.3 billion in tax revenue from this siphoning off of profits. The study author pointed out that actual tax losses were much higher, since the study only covered goods whereas services represented 70% of France's economy.

The study concluded that tax evasion and avoidance via tax havens were all too real a phenomenon, at least in France. It was the work of a relatively small number of multinationals—some 450—that moved their profits offshore to only a dozen tax havens. Mr. Martin's conclusion was that political action targeting these companies and tax havens could yield good results. According to the author, country-by-country reporting would pave the way for targeted policies.

Mr. Martin explained the mechanics of transfer pricing and pointed out that the effect on services and patents was much more pronounced than on goods. Since goods were negotiated, there were market prices against which transfer prices could be benchmarked, but it could be much harder to determine the value of services and patents.

The professor suggested that, for foreign transactions involving items without a market price, profits should be allocated to the countries in which the corporation was considered active based on other criteria such as sales, stocks or employees. Mr. Martin reiterated that country-by-country reporting could produce the information needed to do this.

MAY 12, 2016

Two accounting firms were heard on this day: Raymond Chabot Grant Thornton and KPMG.

Raymond Chabot Grant Thornton

Founded in 1948, Raymond Chabot Grant Thornton is the largest accounting firm in Québec. The firm works with small businesses, large corporations and public and broader public organizations, offering certification, taxation, consulting, turnaround and insolvency services.

Raymond Chabot Grant Thornton pointed out that 20th century tax systems were an outdated model that no longer suited the modern economy with its virtual enterprises. That said, the accounting firm noted that the business it did with low tax rate countries was relatively low in volume—an estimated 0.1%, primarily with Ireland and Luxembourg—and entirely legal.

The firm stated that it did not tolerate tax evasion or abusive tax planning tactics that could be subject to the General Anti-Avoidance Rule and routinely turned away clients whose transactions could be categorized as such. It also turned away taxpayers whose tax haven assets exceeded the legal $100,000 limit if they were not willing to report or voluntarily disclose them. However, its spokespeople were unable to provide statistics on the number of potential clients turned away for these reasons in recent years.

They held that professional firms that helped clients with what was considered abusive tax planning should not be held liable since the term "abusive" was subject to interpretation. Rulings on the matter by the Tax Court of Canada had been overturned by the Federal Court of Appeal.

Raymond Chabot Grant Thornton reminded Committee members that, like most industrialized countries, Canada opted to cede the taxation of active foreign business operations and subsidiaries to their countries of residence.[41] The firm argued that businesses that created subsidiaries in tax havens did it for international expansion rather than tax reasons. It attributed government tax shortfalls from tax havens to tax evasion more than tax avoidance and suggested the Committee explore new tax solutions better suited to the 20th century than income tax, such as taxes on consumption, carbon and tobacco.

KPMG

KPMG is an accounting firm that provides audit, tax and consulting services to a range of businesses, including leading Canadian companies, non-profit organizations and government entities.

KPMG noted that the tax plans it developed for clients all strictly complied with the technical provisions of applicable Canadian and Québec law, but pointed out that these laws evolved over time, as did the public's expectations of companies. Accordingly, the practices it adopted in the 1990s—completely legal at the time—were now illegal and not tolerated by the public.

41 That meant that a Canadian company earning active foreign business income through a subsidiary in a country with which Canada had concluded a tax treaty or tax information exchange agreement would have the right to collect dividends from these foreign subsidiaries without paying Canadian taxes. On the other hand, a company that earned passive income (investment income) in a foreign subsidiary would be taxed annually in Canada even if the income were not paid to the Canadian parent company. Failing to declare such passive income was tax evasion.

Like Raymond Chabot Grant Thornton, KPMG was of the opinion that the international tax system was at odds with the 21st century economy. Therefore, it said, efforts should be made to support the automatic exchange of information and the OECD's new international tax standards. It also noted that tax losses stemmed more from tax evasion than tax avoidance. In its opinion, businesses opened subsidiaries in tax havens for the purposes of international expansion, not strictly tax-related reasons, although they could end up taking advantage of tax arbitrage opportunities available in different countries. Arbitrage is also practiced in Canada, where interest rates vary by province and sector.

When questioned on the possibility of accounting firms' being held liable for abusive tax planning, KPMG pointed out that they already were, citing a 2009 Québec law that penalizes promoters or advisors who set up tax plans for clients with the primary goal of dodging taxes if the plans are confidential or financially reward the promoter or advisor.

Regarding the firm's guilty plea in a 2005 lawsuit brought by the U.S. Internal Revenue Service, the witness pointed out that the case involved KPMG U.S.,[42] not KPMG Canada, that it was an anomaly and that the subsidiary in question had changed dramatically since that time. According to the witness, the same scenario would not happen today.

MAY 19, 2016

On the fifth day of hearings, the Committee heard three other accounting firms: PricewaterhouseCoopers, Deloitte and Ernst & Young.

PricewaterhouseCoopers

PricewaterhouseCoopers is a 100-year-old accounting firm that provides certification, consulting and tax services to public and private companies and government agencies.

PricewaterhouseCoopers estimated that a company's tax burden ranged from 20% to 40% and must be appropriately planned just like any other expense. The firm said it worked within the Canadian and Québec legal systems and did not practice abusive tax planning for its clients. Before accepting a new client or continuing to work with an existing one, the firm ensured the client intended to comply with existing tax law. The firm claimed its fees were not high enough to justify the risks of abusive tax avoidance, i.e., the penalty imposed on promoters in Québec, which is 12.5% of the fees collected.

The spokespeople said that the integrity of their consultants was ensured by having them sign declarations of compliance with the employee code of conduct every year and by basing salaries on the entity's domestic earnings, not individual performance.

PricewaterhouseCoopers also maintained that tax evasion was a much more serious issue than tax avoidance in terms of government tax shortfalls. It backed this statement up with data presented by Québec's Ministère des Finances in a brief submitted as part of the consultation. The firm asked the government to form an independent committee to study all aspects of the tax evasion issue—amounts involved, the cost in lost taxes and potential solutions. Since revenue from tax evasion is what gets funneled into tax havens, PricewaterhouseCoopers reasoned that tax evasion would have to be eradicated to curb tax havens.

42 The Internal Revenue Service sued KPMG and a number of its consultants for helping taxpayers hide money in tax havens. The firm pleaded guilty and had to pay $456 million in fines.

The witnesses then spoke on the 50% compliance rule, by which a transaction can be carried out as long as it complies with at least 50% of legal provisions. PricewaterhouseCoopers admitted that the rule was followed in the industry, adding that the threshold was a starting point for discussions with tax authorities, being that it was based on tax law.

Questioned on whether the firm would help identify failings in Canadian and Québec tax law with an eye to improvement, the witnesses pointed out they were already working closely with the Canada Revenue Agency. The firm regularly helped draft Canadian provisions on international taxation. The witnesses were of the opinion that the Canadian tax system worked well compared to the international tax system.

Regarding the Panama Papers scandal, the witnesses noted that it was unwise to speculate, but that they were prepared to speak out against what the documents revealed, if proven true

Deloitte

Deloitte is one of Canada's largest professional services firms. It offers certification, taxation, consulting and financial advice services to a broad range of Canadian and international clients.

The Deloitte representatives provided an overview of the mechanisms the company used to ensure the quality and compliance of the tax advice it gave clients, including performing a comprehensive background screening of potential clients, following a strict quality assurance process to ensure mission compliance, ensuring employees complied with the code of ethics and rules of professional associations and providing employees with professional development opportunities.

The spokespeople noted the complexity of national and international tax law, whose interpretation leads to disputes between tax authorities and taxpayers. They pointed out that some of these disputes had gone all the way to the Supreme Court of Canada.

The witnesses reminded Committee members that the income Canadian residents earned abroad (meaning active business income) could not be taxed in Canada and that the use of tax treaties was legal. Such provisions existed in almost all sovereign nations, which used tax advantages to attract outside investment. This is what Québec did in its 2016 budget by deciding to tax the marketing of patents at only 4%.

The spokespeople also explained that multinationals build complex structures often headed up by holding companies so they could carry out transactions in more countries. These structures were usually created for business, not necessarily tax, reasons. As for its subsidiaries being active in certain jurisdictions labeled tax havens, Deloitte claimed this spoke to its desire to serve all areas of the world.

Ernst & Young

Ernst & Young is an accounting firm that provides certification, tax, consulting and transactional services.

The firm highlighted its zero tolerance approach to illegal and unethical practices, stating that its internal control mechanisms included an exacting client acceptance process, a requirement that all professionals sign a code of conduct annually, strict protocols for reviewing opinions issued and a legal compliance audit process.

Therefore, claimed the witnesses, the firm did not help clients hide money in tax havens. They also maintained that Canadian firms did not create subsidiaries in tax havens purely for tax reasons. They expressed reservations regarding the third part of the motion on Barbados unanimously adopted on April 14, 2016 by the National Assembly.[43]

43 The text of the motion is presented in Appendix XIII.

According to Ernst & Young, the initiatives by the OECD would help reveal the identities of taxpayers who practiced tax evasion and took advantage of tax havens. The representatives were confident that the automatic exchange of information would detect errors as easily as a self-assessment system would. They pointed out, however, that there would still be discrepancies in national tax rates, citing the new tax rate in Québec of 4% for businesses that commercialize their patents in Québec.

The firm claimed Canada's tax base was not being eroded because income generated in Canada was subject to tax. The firm also recognized Revenu Québec's work fighting tax evasion and stated it would like to see the agency work more closely with its federal counterpart to implement the OECD's recommendations.

SEPTEMBER 15, 2016

On September 15, 2016, the Committee heard four witnesses: Marwah Rizqy, André Lareau, ATTAC-Québec and Alain Deneault.

Marwah Rizqy

Marwah Rizqy is a professor in the Taxation Department at Université de Sherbrooke's School of Management. She is involved with the work of the Research Chair in Taxation and Public Finance.

In her brief, Ms. Rizqy noted that the OECD and the G20 had implemented various measures since 1996. She said these measures had been aimed at combatting tax evasion by individuals and tax avoidance by multinationals—two phenomena that both had at their root the network of tax havens and lack of bank transparency. She also indicated the OECD estimates that tax losses from transfer pricing represented 4% to 10% of corporate income taxes, putting global tax losses at $100 to $240 billion for 2014.

According to the professor, the countries that had signed tax information exchange agreements with Canada did not have any real public apparatus able to follow through, making the agreements little more than promises to cooperate with no actual substance. She also mentioned the tactic used by some countries, including Belgium, Ireland, Luxembourg and the Netherlands, of signing secret agreements with multinationals. Lastly, she lamented the fact that whistleblowers sometimes faced reprisals under the guise of trade or banking secrecy.

Ms. Rizqy emphasized the need for governments to overhaul the legislative framework to allow income from online transactions to be taxed and sales tax to be added to these transactions. This provision should apply to any transaction-based website that was a major player in the Canadian economy. The witness said she favoured using credit cards to identify taxable online transactions since they were the payment method used in 99% of online purchases.

On country-by-country reporting, the expert noted that it was already being done but that countries lack the resources to analyze the data being generated. To those who decried the role of banks in the use of tax havens, Ms. Rizqy took a more nuanced approach. In her opinion, financial institutions operated within a legislative framework inconsistent with the global economic and business context, so the first step was for countries to overhaul their legislation. Banks were making an effort, but certain suspicious practices warranted investigation.

With respect to the tax treaties signed by Canada, the witness opined that Québec could withdraw from them and tax income made in the countries protected by the agreements, but she questioned whether that was the best course. The need to standardize the rules between Québec and the federal government to maintain a consistent and stable tax system would make it difficult for Québec to wash its hands of these agreements. The professor mentioned she would like Québec to be consulted on Canada's tax treaties and information exchange agreements, since Québec would likely be impacted by certain provisions, e.g., those on transfer pricing and permanent establishment.

As for the Uber debate, the professor noted that what concerned her more than the collection of GST and QST on fares, the taxing of partner driver income and the company's corporate income were the royalties—to the tune of 20%—that Uber routinely diverted to the Netherlands. Ms. Rizqy wondered if, in the discussions with the company to permit it to carry out activities legally in Québec, the possibility of taxing these royalties was being considered.

André Lareau

André Lareau is a professor with Université Laval's Faculty of Law and legal counsel with Joli-Cœur Lacasse. He regularly represents clients in litigation pitting them against the tax department. He is an expert in tax litigation, planning and policy.

Mr. Lareau started by saying tax havens continued to be an issue Canadian tax authorities were unable to control due to three factors. According to Mr. Lareau, the first was that it was impossible to control what you could not see and did not know about. Since the phenomenon largely took place outside Canada, he recommended that Canada Revenue Agency staff actually go to these locations to investigate. Mr. Lareau stressed the fact that, by not visiting the tax havens, Canadian and Québec agencies were missing out on valuable account information—something he had experienced first-hand.

The second factor had to do with the inexpediency of the tax law system and diffidence of the Canadian courts. He cited the General Anti-Avoidance Rule, which labelled any arrangement without a bona fide business purpose as tax evasion. Meanwhile the Canadian courts had found that tax expenses had a bona fide business purpose, which meant businesses could optimize them. The professor called on the government to modify or clarify the definition of "bona fide business purpose" to exclude taxes at its first opportunity.

The final factor, he said, was the fact that professional firms crafted substantive international tax strategies and complex financial packages for wealthy clients and multinationals.

Questioned on the merits of BEPS, the professor responded that the OECD efforts were commendable, but that he believed we should look at measures that could be deployed locally on a smaller scale rather than waiting for huge international initiatives to be implemented.

He felt that the tax information exchange agreements Canada signed did nothing but open the door to low tax jurisdictions for businesses. In his opinion, voluntary disclosure may be working, but it also rewarded fraud. While voluntary disclosure may be acceptable for people who honestly failed to declare small amounts, it was unacceptable in deliberate tax evasion cases involving large amounts.

Mr. Lareau maintained that, contrary to popular opinion, Québec could and should go it alone in the fight against tax havens. He conceded that the approach could negatively impact the Québec economy in the near term, but maintained that it was a price to pay if we were to effectively curb the practice. According to Mr. Lareau, someone must take the lead and set an example for other jurisdictions, and Québec was perfectly capable of doing so.

He made a few recommendations:

- Do away with voluntary disclosure except in cases of good faith involving relatively low amounts
- Tax amounts that are deducted from foreign taxable income when taken as dividends in Canada
- Grant a tax credit equal to the foreign income tax paid rather than allowing people to repatriate it to Canada as a tax deduction

- Give the courts the tools they need to make rulings that take into account tax morality
- Allow revenue agency staff to travel to tax havens to investigate
- Specify in tax law that professional assistance in tax evasion or abusive tax avoidance is a criminal activity
- Make professional firms that abet tax evasion and abusive tax avoidance ineligible for government contracts

ATTAC-Québec

ATTAC (Association pour une taxe sur les transactions financières et pour l'action citoyenne) was created in France in 1998 and operates in some 20 countries today. Formed in 2000, the Québec division, ATTAC-Québec, is the movement's only chapter in North America. The group advocates for a tax on financial transactions and the elimination of tax havens.

According to ATTAC-Québec, banks were not necessarily responsible for the existence of tax havens, but without their collaboration and complicity and the tools they put in place, the phenomenon would not be growing. Therefore, governments must get banks to cooperate or require them to implement mechanisms that would stop tax havens in their tracks.

According to ATTAC-Québec, major corporations and their lobbies weakened governments. The group mentioned three mechanisms at play. First, by borrowing at interest from financial institutions rather than their central bank virtually interest-free, governments have markedly increased their expenses in recent years. What this meant to ATTAC-Québec is that a chunk of government money is going to benefit corporations. Therefore, by granting all kinds of tax loopholes to the wealthy and major corporations, the government is depriving itself of critical revenue. Furthermore, free trade agreements empower multinationals and their lobbies, which over the years have gradually chipped away at governments' ability to legislate and regulate. The organization set forth eight recommendations for the Quebec government to crack down on tax havens:

- Calculate the annual tax losses that can be attributed to the existence of tax havens
- Require banks to report their activities in Québec
- Require the Caisse de dépôt et placement du Québec to pressure investor businesses to close all subsidiaries in tax havens
- Require government contractors to demonstrate that they do not use tactics involving lax jurisdictions
- Disqualify candidates for tax credits and subsidies who use aggressive tax planning strategies
- Earmark more funds to aggressive tax planning audits
- Pressure the federal government to actively support anti-tax haven measures in its foreign policy
- Tax the income multinationals generate in Québec
- Sign its own tax treaties with countries that support the automatic exchange of tax information
- Make tax avoidance illegal

Further discussions between the Committee members and ATTAC-Québec largely focused on the scope and feasibility of some of these recommendations.

Alain Deneault

Alain Deneault is the research director of the Collège International de Philosophie and a researcher with the Réseau pour la Justice Fiscale. He has written several books about tax havens. He participated in the Committee on Public Finance hearings as a representative of Réseau pour la Justice Fiscale.

Mr. Deneault started by pointing out that he studied tax havens from the perspective of political thought. Accordingly, he saw tax havens as adversaries of the rule of law because they served primarily to neutralize the way countries imposed the rule of law within their borders. He felt there were three clear conclusions.

One was that Canada was not a credible partner in the fight against tax treaties, as evidenced by its tax agreement with Barbados and weak response to the Panama Papers revelations.

Second, he said Québec must assert its power within Canada by withdrawing from and refusing to honour Canadian tax treaties.

Third, Québec must innovate, for instance by taxing multinationals on the basis of the income they generated in Québec.

Mr. Deneault said that international efforts to combat tax havens did not address the structures in these jurisdictions—they just tried to police their activity somewhat. He spoke out against Canada's laxity in countering tax havens, verging on complicity.

In response to a question on the advisability of a global multinational tax body to redistribute taxes to host countries according to the activities companies actually carried out there, the expert indicated that there would always be countries that would block the move. He suggested that Québec implement a multinational income tax instead—a solution that could be contingent on a similar measure being adopted by other countries representing an as-yet-undetermined percentage of the total population of these countries. He was also unenthusiastic about country-by-country reporting. He said it could work in the case of small businesses that had only one or two subsidiaries in a tax haven. But in the Paris region, financial institutions were required to do country-by-country reporting, and those that had subsidiaries in tax havens and did not comply with country-by-country reporting requirements were boycotted by potential clients.

With respect to the possibility that Québec could impose a tax like the Google tax in the United Kingdom, Mr. Deneault said there was a lot Québec could be doing, but was not doing. Under the Canadian Constitution, Québec has absolute sovereignty in tax collection, so it could create such a tax, just as it could create a tobacco tax or health tax.

In conclusion, Mr. Deneault asked Committee members to think outside the box and pass laws reflecting public concern over tax havens.

PART THREE

COMMITTEE OBSERVATIONS, CONCLUSIONS AND RECOMMENDATIONS

Committee members note that, as expected, witnesses had wide-ranging views on the use of tax havens and potential countermeasures. Some claimed that there were no more tax havens—only low tax jurisdictions—and that the government lost tax dollars to tax evasion more than tax avoidance. Others claimed that abusive offshore tax avoidance was all too real and that fighting it would require standardizing international tax rules and implementing OECD recommendations. Finally, some witnesses felt Québec should withdraw from the tax treaties Canada had signed and adopt local anti-tax haven measures.

The members of the Committee on Public Finance acknowledge these conflicting viewpoints and have noted both the Canada Revenue Agency's responses to their written questions and the anti-tax haven measures included in the 2016–2017 federal budget. They are concerned by the fact that certain financial institutions and accounting firms deny the existence of tax havens and any connection between lost government tax dollars and abusive tax avoidance via tax havens.

The members recognize that the clandestine nature and impenetrability of operations in these jurisdictions further complicate and confuse the issue, but they hope their work and this report will help shed some light. They realize that much has been done in Québec to fight tax evasion and tax avoidance via tax havens since 2009. They agree that, although existing measures should be maintained, the focus must switch to coordinating and standardizing tax policy at the international level. Accordingly they are supportive of efforts by the OECD, specifically its Action Plan on Base Erosion and Profit Shifting (BEPS).

The Committee concedes that most of the OECD's recommended actions fall within the purview of the federal government, but notes that Québec has the authority to implement some of them without federal involvement. Therefore the Committee's recommendations are aimed at the Quebec government directly, but members would like to see the provincial and federal governments discuss some of the other suggestions and agree on strategies for future implementation. To that end, the Committee on Public Finance makes the following observations and recommendations.

RECOMMENDATIONS TO BE IMPLEMENTED BY THE QUÉBEC GOVERNMENT

Google tax

Most multinationals practice tax reduction or tax avoidance in order to lessen their tax burden—transfer pricing between subsidiaries being the most common method. Transfer pricing allows multinationals to route profits to subsidiaries in low tax rate countries to cut their total tax bills. They also use complex schemes to carry out activities in countries without paying any taxes at all. E-commerce makes it easier to divert earnings to low tax rate countries. The Google tax, which imposes a levy on profits routed to low tax jurisdictions, was designed to counter this practice. Google tax provisions have been adopted in the United Kingdom, Australia and France. Québec could follow suit. Therefore, the Committee on Public Finance recommends:

That the Ministère des Finances du Québec:

1. Study the economic impact of a tax on diverted profits (Google tax) and submit its findings to the Committee on Public Finance by September 2017. Identify in the report the rate or rates at which diverted profits should be taxed.

That Revenu Québec:

2. Work with the Ministère des Finances du Québec and use country-by-country reports to estimate the annual profits earned in Québec and diverted to avoid taxation.

That the Québec government:

3. Amend the legislative framework to allow online transactions to be taxed using the credit cards used to pay for purchases.

Non-resident trusts

Up until 2006, Canada considered a trust non-resident if the contributor and beneficiaries lived in Canada but the administrators (trustees) did not. Earnings on this type of trust were not taxable. But according to a witness heard during the public hearings, the federal government amended the *Income Tax Act* in 2006, and as a result, these types of trusts have been considered resident and therefore subject to federal income tax since 2007. Québec had announced that it would follow suit, but as of 2015 Québec's *Taxation Act* had still not been amended, according to the witness. Therefore, the Committee on Public Finance recommends:

That the Ministère des Finances du Québec:

4. Assess the tax status of non-resident trusts in Québec with an eye to amending the *Taxation Act* so they will be considered resident.

Canadian tax treaties

Multiple witnesses in the public hearings mentioned the fact that the tax treaties Canada has signed with tax havens make it possible for taxpayers to route wealth from low tax jurisdictions to Canada tax-free. Specific examples include dividends deducted in tax havens and untaxed or undertaxed income in Canada's partner jurisdictions. The Canadian tax exemption is permissible under Regulation 5907 of the Canadian *Income Tax Act*. On April 14, 2016, the National Assembly unanimously passed a motion asking the federal government to amend Section 95(1) of the *Income Tax Act* and Section 5907 of the Income Tax Regulations (the resolution is in Appendix XIII). Some witnesses felt the regulation violated the *Income Tax Act* itself. Others thought Québec should withdraw from the Canadian tax treaties to determine the best way to tax those who have dealings with tax havens. To make up Québec's shortfall and clarify the other two points raised by witnesses, the Committee on Public Finance recommends:

That the Québec government:

5. Tax dividends received in Québec that have been subject to foreign deductions.

6. Grant a tax credit equal to the foreign income tax paid rather than allowing the income to be brought back into Québec tax-free.

That the Ministère des Finances du Québec:

7. Seek out a legal opinion on Section 5907 of the Income Tax Regulations and submit it to the Committee on Public Finance by September 2017.

8. Study the feasibility of Québec's withdrawing from certain Canadian tax treaties, what the economic impact of such a move would be and how best to proceed should it choose to do so, and submit its findings to the Committee on Public Finance by September 2017.

Central business register

Many multinationals dodge taxes in countries where they do business by transferring funds to tax havens. Creating an anonymous shell company is a common tactic used to cover up these transactions. Anonymous shell companies are fictitious corporations for which it is difficult, if not impossible, to track down the identity of the real owners or ultimate beneficial owners. Recent studies have shown that it is very easy to create a shell company in developed nations, including the United States, Canada and Québec. Experts (including at least one Nobel Prize winner in economics) recently recommended that countries create central registers to record information on ultimate beneficial ownership of these entities. Australia, Denmark, Norway, the Netherlands and the United Kingdom all established such registers between 2014 and 2016. Given its belief that Québec could gain credibility in the fight against tax havens by prohibiting anonymous shell companies, the Committee on Public Finance recommends:

That the Registraire des entreprises du Québec:

9. Begin working as quickly as possible with the relevant ministries and organizations to develop a central public business register for Québec that tracks ultimate beneficial owners and that can identify via a name search all businesses in which individual taxpayers have a stake.

That the Québec government:

10. Estimate and allocate the human, financial and material resources needed by the Registraire des entreprises du Québec to create a central public business register for Québec.

11. Amend the laws on partnerships and corporations and potentially the Civil Code (for sole proprietorships) to prevent businesses that do not provide sufficient information on their ultimate beneficial owners from being registered in Québec.

Country-by-country reporting and tax rulings

Country-by-country reporting is one of the measures recommended by the Organisation for Economic Co-operation and Development (OECD) to facilitate the exchange of tax information on multinationals between the tax authorities in the countries where these businesses operate. The OECD has developed a form multinationals must complete and submit to the tax authority in the parent company's country of residence. The form includes information on each subsidiary's sales, profits and taxes. Businesses with consolidated revenue of at least €750 million (over CA$1.1 billion) are required to do country-by-country reporting. The OECD stipulates that this is intended to be a minimum standard, which means countries can lower the threshold or take more restrictive action. Reporting is required for the 2015 tax year and beyond.

In the 2016–2017 budget, Canada agreed to apply the OECD's recommendation beginning in June 2018. On July 29, 2016, the federal government published draft legislation for public comment that would introduce country-by-country reporting requirements. The legislation maintains the €750 million threshold and establishes penalties for fraud or failure to file.

The OECD also recommends that countries spontaneously exchange information on tax rulings with partner countries to successfully counter harmful tax practices. This would include tax rulings on preferential regimes, transfer pricing arrangements and permanent establishments. In the 2016–2017 budget speech, Canada also committed to implementing the spontaneous exchange of information on tax rulings standard beginning in 2016. It also gave assurances that information would be exchanged with due regard to confidentiality, as per standard practice.

Certain reports and rulings obtained by the Canada Revenue Agency would undoubtedly be of use to Revenu Québec. Therefore, the Committee on Public Finance recommends:

That Revenu Québec:

12. Obtain from the Canada Revenue Agency and analyze the country-by-country reports of multinationals with operations in Québec.

13. Work with the Canada Revenue Agency to obtain tax information and rulings impacting Québec that the federal agency exchanges with or receives from Canada's partner countries.

That the Québec government:

14. Assess and allocate the additional human, financial and material resources Revenu Québec needs to step up audits and analyze the information collected as a result of new international tax measures in the federal government's 2016–2017 budget.

Mandatory and voluntary disclosure

Transactions are subject to mandatory disclosure in Québec where they result in a benefit to the taxpayer of $25,000 or more, or have an impact on the taxpayer's income of $100,000 or more and entitle the promoter or advisor to remuneration. Failure to comply with this regulation by the set deadline exposes the taxpayer to a penalty of $10,000 to $100,000.

Voluntary disclosure, on the other hand, is a Québec provision that permits taxpayers that have failed to disclose income or have provided inaccurate information to bring their files into compliance by providing the missing information. The taxpayer then has to pay the taxes due and any interest incurred, but does not face any penalties and is not taken to court. Some witnesses felt that voluntary disclosure was like rewarding fraud if there were no consequences attached. Therefore, the Committee on Public Finance recommends:

That Revenu Québec:

15. Better enforce compliance with the Québec provision on transactions subject to mandatory disclosure.

That the Québec government:

16. Allocate more resources to enforcing compliance with the mandatory disclosure and abusive tax avoidance provision.

17. Do away with voluntary disclosure except in cases of good faith involving low amounts.

Tax credits for research and development

One tactic multinationals use is to spend on research and development in a developed country and then transfer the resulting intellectual property to tax havens or countries offering regimes preferential to intellectual property revenues (patent box regimes). Very often, companies benefit from tax credits for this research in the country of origin, which suffers doubly as a result, paying the tax credit yet collecting no taxes on the subsequent intellectual property revenues. Knowing that this can happen in Québec, the Committee on Public Finance recommends:

That the Québec government:

18. Make companies ineligible for research and development tax credits if they transfer the resulting intellectual property to a tax haven or low tax jurisdiction.

New types of business relationships

Québec must take steps to ensure the government and the companies in the province have no dealings with entities that practice tax evasion or tax avoidance, especially via tax havens. To that end, the Committee on Public Finance recommends:

That the Québec government:

19. Ask the Caisse de dépôt et placement du Québec to gradually reduce investments in companies that practice abusive tax avoidance or tax evasion and to provide updates on these efforts in its annual report.

20. Ask the Caisse de dépôt et placement du Québec to require companies in which it has invested significantly, thereby affording it some say in their governance, to stop using tax havens.

21. Stop using suppliers that have been found guilty of abusive tax avoidance or tax evasion or using tax havens.

22. Make businesses that have been found guilty of abusive tax avoidance ineligible for government subsidies.

23. Make professional firms that have been found guilty of abetting tax evasion and abusive tax avoidance ineligible for government contracts.

24. Specify in applicable laws that providing professional assistance designed to aid or abet tax evasion or abusive tax avoidance is a criminal activity.

OTHER RECOMMENDATIONS

Points not falling under any of the above categories are presented here. Therefore, the Committee on Public Finance recommends:

That the Québec government:

25. Amend the *Act respecting the protection of personal information in the private sector* to require any taxpayer suspected of having dealings with a financial institution in a tax haven to release (using the regular procedure) the financial institution from any duty of confidentiality with respect to the taxpayer's bank accounts..

26. Adopt a law to protect and possibly compensate whistleblowers who help reveal tax evasion or abusive tax avoidance at or above a yet-to-be determined amount.

27. Establish a centre of expertise in the fight against tax evasion and abusive tax avoidance.

RECOMMENDATIONS TO BE DISCUSSED WITH THE FEDERAL GOVERNMENT

That the Québec government discuss with the federal government whether it can:

28. Draft legislation on research and development tax credits for federally chartered companies in order to make such credits contingent on not transferring the intellectual property resulting from the research and development to a tax haven or low tax jurisdiction.

29. Have the Canada Revenue Agency estimate the profits generated annually by Canadian multinationals and routed to tax havens to be taxed at a yet-to-be-determined rate (Google tax) and transmit information concerning Québec to Revenu Québec..

30. Amend the relevant law(s) to require any Canadian taxpayer suspected of having dealings with a financial institution in a tax haven to release (using the regular procedure) the financial institution of any duty of confidentiality with respect to the taxpayer's bank accounts.

31. Amend the *Income Tax Act* and associated regulations, specifically Section 95(1) of the *Income Tax Act* and Section 5907 of the Income Tax Regulations, to tax at a yet-to-be-determined rate income or wealth from tax havens with which Canada has tax treaties..

32. Create a central public register of the ultimate beneficial owners of federally chartered corporations.

33. Add provisions to the Criminal Code for misstatements or omissions in Canada's existing central registers.

34. Add provisions to the Criminal Code for the aiding and abetting of abusive tax avoidance by law, accounting or tax firms, or by banks or other promoters.

35. Specify in applicable laws that providing professional assistance designed to aid or abet tax evasion or abusive tax avoidance is a criminal activity.

36. Reduce the revenue threshold of €750 million (over CA$1.1 billion) for Canadian businesses subject to country-by-country reporting.

37. Make corporate country-by-country reports public, as the European Union has done since an April 2016 decision.

38. Make supporting the fight against tax havens a foreign policy priority.

LIST OF RECOMMENDATIONS

RECOMMENDATIONS TO BE IMPLEMENTED BY THE QUÉBEC GOVERNMENT

Google tax

That the Ministère des Finances du Québec:

1. Study the economic impact of a tax on diverted profits (Google tax) and submit its findings to the Committee on Public Finance by September 2017. Identify in the report the rate or rates at which diverted profits should be taxed.

That Revenu Québec:

2. Work with the Ministère des Finances du Québec and use country-by-country reports to estimate the profits earned annually in Québec and diverted to avoid taxation.

That the Québec government:

3. Amend the legislative framework to allow online transactions to be taxed using the credit cards used to pay for purchases.

Non-resident trusts

That the Ministère des Finances du Québec:

4. Assess the tax status of non-resident trusts in Québec with an eye to amending the *Taxation Act* so they will be considered resident.

Canadian tax treaties

That the Québec government:

5. Tax dividends received in Québec that have been subject to foreign deductions.
6. Grant a tax credit equal to the foreign income tax paid rather than allowing the income to be brought back in to Québec tax-free.

That the Ministère des Finances du Québec:

7. Seek out a legal opinion on Section 5907 of the Income Tax Regulations and submit it to the Committee on Public Finance by September 2017.
8. Study the feasibility of Québec's withdrawing from certain Canadian tax treaties, what the economic impact of such a move would be and how best to proceed should it choose to do so, and submit its findings to the Committee on Public Finance by September 2017.

Central business register

That the Registraire des entreprises du Québec:

9. Begin working as quickly as possible with the relevant ministries and organizations to develop a central public business register for Québec that tracks ultimate beneficial owners and that can identify via a name search all businesses in which individual taxpayers have a stake.

That the Québec government:

10. Estimate and allocate the human, financial and material resources needed by the Registraire des entreprises du Québec to create a central public business register in Québec.

11. Amend the laws on partnerships and corporations and potentially the Civil Code (for sole proprietorships) to prevent businesses that do not provide sufficient information on their ultimate beneficial owners from being registered in Québec.

Country-by-country reporting and tax rulings

That Revenu Québec:

12. Obtain from the Canada Revenue Agency and analyze the country-by-country reports of multinationals with operations in Québec.

13. Work with the Canada Revenue Agency to obtain tax information and rulings impacting Québec that the federal agency exchanges with or receives from Canada's partner countries.

That the Québec government:

14. Estimate and allocate the additional human, financial and material resources Revenu Québec needs to step up audits and analyze the information it obtains as a result of new international tax measures in the federal government's 2016–2017 budget.

Mandatory and voluntary disclosure

That Revenu Québec:

15. Better enforce compliance with the Québec provision on transactions subject to mandatory disclosure.

That the Québec government:

16. Allocate more resources to enforcing compliance with the provision on mandatory disclosure and abusive tax avoidance.

17. Do away with voluntary disclosure except in cases of good faith involving low amounts.

Tax credits for research and development

That the Québec government:

18. Make companies ineligible for research and development tax credits if they transfer the resulting intellectual property to a tax haven or low tax jurisdiction.

New types of business relationships

That the Québec government:

19. Ask the Caisse de dépôt et placement du Québec to gradually reduce investments in companies that practice abusive tax avoidance or tax evasion and to provide updates on these efforts in its annual report.

20. Ask the Caisse de dépôt et placement du Québec to require companies in which it has invested significantly, thereby affording it some say in their governance, to stop using tax havens.
21. Stop using suppliers that have been found guilty of abusive tax avoidance or tax evasion or using tax havens.
22. Make businesses that have been found guilty of abusive tax avoidance ineligible for government subsidies.
23. Make professional firms that have been found guilty of abetting tax evasion and abusive tax avoidance ineligible for government contracts.
24. Specify in applicable laws that providing professional assistance designed to aid or abet tax evasion or abusive tax avoidance is a criminal activity.

OTHER RECOMMENDATIONS

That the Québec government:

25. Amend the *Act respecting the protection of personal information in the private sector* to require any taxpayer suspected of having dealings with a financial institution in a tax haven to release (using the regular procedure) the financial institution from any duty of confidentiality with respect to the taxpayer's bank accounts.
26. Adopt a law to protect and possibly compensate whistleblowers who help reveal tax evasion or abusive tax avoidance at or above a yet-to-be determined amount.
27. Establish an international centre of expertise in the fight against tax evasion and abusive tax avoidance.

RECOMMENDATIONS TO BE DISCUSSED WITH THE FEDERAL GOVERNMENT

That the Québec government discuss with the federal government whether it can:

28. Draft legislation on research and development tax credits for federally chartered companies in order to make such credits contingent on not transferring the intellectual property resulting from the research and development to a tax haven or low tax jurisdiction.
29. Have the Canada Revenue Agency estimate the profits generated annually by Canadian multinationals and routed to tax havens to be taxed at a yet-to-be-determined rate (Google tax) and transmit information concerning Québec to Revenu Québec.
30. Amend the relevant law(s) to require any taxpayer suspected of having dealings with a financial institution in a tax haven to release (using the regular procedure) the financial institution from any duty of confidentiality with respect to the taxpayer's bank accounts.
31. Amend the *Income Tax Act* and associated regulations, specifically Section 95(1) of the *Income Tax Act* and Section 5907 of the Income Tax Regulations, to tax at a yet-to-be-determined rate income or wealth from tax havens with which Canada has tax treaties.
32. Create a central public register of the ultimate beneficial owners of federally chartered corporations.
33. Add provisions to the Criminal Code for misstatements or omissions in Canada's existing central registers.
34. Add provisions to the Criminal Code for the aiding and abetting of abusive tax avoidance by law, accounting or tax firms, or by banks or other promoters.

35. Specify in applicable laws that providing professional assistance designed to aid or abet tax evasion or abusive tax avoidance is a criminal activity.

36. Reduce the €750 million revenue threshold (over CA$1.1 billion) for Canadian businesses subject to country-by-country reporting.

37. Make corporate country-by-country reports public, as the European Union has done since an April 2016 decision.

38. Make supporting the fight against tax havens a foreign policy priority.

APPENDIX I: U.S. CONGRESSIONAL RESEARCH SERVICE LIST OF TAX HAVENS

Caribbean/West Indies	Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, British Virgin Islands, Cayman Islands, Dominica, Grenada, Montserrat, Netherlands Antilles, St. Kitts and Nevis, St. Lucia, St. Vincent and Grenadines, Turks and Caicos, U.S. Virgin Islands
Central America	Belize, Costa Rica, Panama
Coast of East Asia	Hong Kong, Macau, Singapore
Europe/Mediterranean	Andorra, Channel Islands (Guernsey and Jersey), Cyprus, Gibraltar, Isle of Man, Ireland, Liechtenstein, Luxembourg, Malta, Monaco, San Marino, Switzerland
Indian Ocean	Maldives, Mauritius, Seychelles
Middle East	Bahrain, Jordan, Lebanon
North Atlantic	Bermuda
Pacific, South Pacific	Cook Islands, Marshall Islands, Samoa, Nauru, Niue, Tonga, Vanuatu
West Africa	Liberia

Source: Congressional Research Service, *Tax Havens: International Tax Avoidance and Evasion*, January 15, 2015.

APPENDIX II: U.S. CONGRESSIONAL RESEARCH SERVICE LIST OF JURISDICTIONS WITH TAX HAVEN CHARACTERISTICS

Countries	Canada, Denmark, Hungary, Iceland, Israel, Netherlands, Portugal, United Kingdom, United States
U.S. states	Delaware, Nevada, Wyoming
City	Campione d'Italia (Italy)

Source: Congressional Research Service, *Tax Havens: International Tax Avoidance and Evasion*, January 15, 2015.

APPENDIX III: *FORBES* MAGAZINE'S LIST OF THE WORLD'S TOP TEN TAX HAVENS

1. Delaware
2. Luxembourg
3. Switzerland
4. Cayman Islands
5. City of London
6. Ireland
7. Bermuda
8. Singapore
9. Belgium
10. Hong Kong

Source: "World's Best Tax Havens," *Forbes*, July 6, 2010.

APPENDIX IV: KEY CANADIAN ANTI-TAX HAVEN MEASURES IMPLEMENTED BEFORE THE MARCH 2016 BUDGET

- Signing of tax information exchange agreements (TIEAs): In April 2016 Canada signed 22 tax information exchange agreements and 92 tax treaties.
- Transfer pricing regulations: Canada has applied the arm's length principle since the mid-1990s and has complied with required OECD updates ever since.
- Voluntary disclosure:[44] This provision, which has existed since 1987, offers taxpayers the possibility to make good on their tax obligations while avoiding certain penalties.
- General Anti-Avoidance Rule (GAAR[45]): Introduced in 1988, the GAAR allows the tax department to charge taxpayers who dodge taxes the equivalent of the tax advantage they received.[46]
- The obligation for taxpayers who own specified foreign property[47] worth $100,000 or more or who have shares of $100,000 or more in a foreign affiliate to declare it using a specific form.[48] There are penalties for failure to comply.[49]
- Penalties for third parties who provide misleading information for the purposes of promoting planning services or who help taxpayers make false statements.[50]
- Taxpayers' obligation to declare any avoidance transaction in which they obtain contractual protection or the promoter or tax advisor earns fees or has confidential protection for the transaction. There are penalties for failure to comply with this rule (in effect since June 2013) by June 30 of the calendar year following the year in which the transaction became a reportable transaction.
- The requirement announced in 2013 that taxpayers provide more detailed information about foreign property valued at more than $100,000. Forms T1134 and T1135 were updated accordingly. There are penalties for false statements.
- Launch of an informant program that offers financial rewards to individuals who provide leads on taxpayers practicing offshore tax evasion.[51] Rewards may vary from 5% to 15% of recovered taxes over and above $100,000.
- The requirement introduced on January 1, 2015, that financial institutions (banks, credit unions, caisses populaires, financial services cooperatives, trust and loan companies), money service businesses and casinos report international electronic funds transfers (EFTs) of $10,000 or more to the Canada Revenue Agency (CRA).

44 For more information, see Canada Revenue Agency *Information Circular IC00-1R3* – Voluntary Disclosures Program (VDP), March 21, 2013.
45 Section 245 of the *Income Tax Act*.
46 Ontario and Québec also have General Anti-Avoidance Rule provisions.
47 Specified foreign property that must be declared includes funds held outside Canada, shares of non-resident corporations, interests in non-resident trusts, real property other than property for personal use and real estate used in an active business.
48 Form T1134 – Information Return Relating to Controlled and Not-Controlled Foreign Affiliates or Form T1135 – Foreign Income Verification Statement.
49 *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.), Section 162(7) and 162(10).
50 *Ibid.*, Section 163(2).
51 The informant program existed before, but a legislative framework that includes rewards could be a further incentive for those who have information.

- Expansion of the thin capitalization rule to include new debts, reduce the debt-to-equity threshold from 2 to 1.5 and apply to all trusts resident in Canada and non-resident trusts operating a business in Canada.[52] These three changes are in keeping with existing practices in other industrialized countries.
- Restrictions on the deductibility of expenses or taxation of a source deduction when payments are made to beneficiaries residing in tax havens.
- Levying of a departure tax when an individual, company or trust gives up Canadian residency.

52 Like rules in effect in many other countries, Canada's thin capitalization rule aims to curb excessive interest deductions on loans from non-resident affiliates. Under this rule, loans from a specified non-resident shareholder to a Canadian company cannot exceed the debt-to-equity ratio limit, failing which deduction of some or all of the interest the Canadian taxpayer paid on the loan will be disallowed and will be treated as dividend paid to the non-resident from the after-tax earnings. Under this rule, "specified non-resident shareholder" means a person who either alone or together with persons with whom the person does not deal at arm's length owns shares representing 25% or more of the votes attached to, or the fair market value of, the issued and outstanding shares of the corporation.

APPENDIX V: TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING

Transfer pricing documentation

Transfer prices are the prices at which a multinational's affiliated entities in different countries trade goods, services and intangibles across international borders.

The tax rules in Canada and many other countries require multinationals to set transfer prices based on the arm's length principle. They are required to prepare transfer pricing documentation to describe their intra-group transactions and the methodologies they applied to set prices for these transactions. Documentation must comply with the Transfer Pricing Guidelines in their original version adopted by the OECD in 1995. The guidelines were updated a first time in 1996–1999 with additional guidance on cross-border services, intangibles, cost contribution arrangements and advance pricing arrangements. In the 2009–2010 edition, updates related primarily to dispute resolution, pricing methods and business restructurings were made.

In July 2015, as part of the BEPS Project, the OECD revised the Transfer Pricing Guidelines to reflect new transfer pricing documentation standards.

The revisions touched on divisions between transactions and setting prices for goods, intangibles and low value-added services. Additional guidance on cost contribution and profit-sharing arrangements, financial transaction transfer pricing and the attribution of profits to permanent establishments is slated for 2016.

According to the Canadian government, adoption of the new guidelines will vary by country depending on how each country's rules interact with the new guidelines. However, as an active participant in the OECD's work on transfer pricing, Canada plans to adopt the new Transfer Pricing Guidelines soon if required.

Country-by-country reporting

The country-by-country report is an OECD form that multinationals will be required to file with the tax authorities in the country in which their ultimate parent entity resides. Country-by-country reports include revenue, profit, tax paid, stated capital, accumulated earnings, number of employees and tangible assets, as well as the main activities of each of its subsidiaries.

When a jurisdiction receives a country-by-country report from a member of a multinational, that jurisdiction will automatically exchange the report with other jurisdictions in which the multinational operates, provided that the jurisdictions have implemented country-by-country reporting and have entered into an automatic exchange of information agreement. If these conditions are not met, additional measures are provided for—a subsidiary can be designated to represent the group for the purposes of filing the country-by-country report. The representative subsidiary will then file the report for the subsidiaries in jurisdictions that have not implemented country-by-country reporting or the automatic exchange of information.

In keeping with BEPS project recommendations, country-by-country reporting will be required for taxation years that begin after 2015.

Canada's 2016–2017 budget calls for implementation of country-by-country reporting. This measure will apply only to multinationals with total annual consolidated group revenue of €750 million ($1.2 billion) or more.

Canadian resident multinationals (or the Canadian resident subsidiary) will be required to file country-by-country reports with the Canada Revenue Agency within one year of the end of the fiscal year to which the reports relate.

First exchanges between jurisdictions of country-by-country reports are expected to occur by June 2018. Before beginning such exchanges with other jurisdictions, the Canada Revenue Agency will formalize exchange arrangements with the jurisdictions and ensure that it has appropriate safeguards in place to protect report confidentiality. According to the federal government, draft legislative proposals will be released for public comment in the coming months.[53]

53 The legislative proposals were issued for comment on July 29, 2016 (see footnote on Page 19).

APPENDIX XI: REVISED TRANSFER PRICING GUIDANCE

That transfer prices should reflect arm's length terms is the basis of Article 9 of the OECD and United Nations Model Tax Conventions. The arm's length principle is also included in all of Canada's tax treaties, as mandated by Section 247 of the Income Tax Act. Although the Transfer Pricing Guidelines are not explicitly incorporated into Canada's legislation, they are used by taxpayers, the Canada Revenue Agency and the courts for interpreting and applying Section 247.

Consistent application of the Transfer Pricing Guidelines across jurisdictions helps to ensure the proper measurement of taxable income in each jurisdiction, avoid double taxation, minimize inter-jurisdictional conflict between tax authorities and foster international trade and investment.

The revised Transfer Pricing Guidelines from the BEPS project are aimed at providing improved interpretation of the arm's length principle and better alignment between the profits of multinationals and the economic activities generating those profits.

According to the Canadian government, the new OECD guidelines generally dovetail with the Canada Revenue Agency's current interpretation and application of the arm's length principle. These revisions are thus being applied by the Canada Revenue Agency as they are consistent with current practices. Where the OECD has yet to pronounce on certain revisions, Canada will decide on a course of action after it does so.

APPENDIX XII: TAX TREATY ABUSE

Tax treaty abuse, and in particular treaty shopping, is one of the biggest sources of base erosion and profit shifting.

Treaty shopping occurs when third-country residents create intermediary holding companies in treaty countries for the purpose of channelling income and profit generated in Canada through that company to qualify for tax treaty benefits that would not otherwise have been available to them. It undermines the bilateral nature of tax treaties and the balance of compromise between the treaty partners.

The BEPS project sets a minimum standard to curb the abusive use of tax treaties. The standard requires countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

The standard also requires countries to implement this common intention by adopting in their tax treaties one of two approaches to treaty anti-abuse rules:

- The principal purpose test, which consists of determining whether one of the principal purposes of an arrangement or transaction was to obtain treaty benefits in a way not in accordance with the object and purpose of the treaty.
- The limitation-on-benefits rule, which requires satisfaction of a series of tests in order to qualify for treaty benefits.

Budget 2016–2017 shows the federal government's commitment to address treaty abuse in accordance with the OECD minimum standard. Canada currently has one treaty that uses a limitation-on-benefits approach as well as several treaties with a limited principal purpose test.

Going forward, Canada will consider either minimum standard approach, depending on the particular circumstances and discussions with Canada's tax treaty partners.

Amendments to Canada's tax treaties to include treaty anti-abuse rules could be achieved through bilateral negotiations, the multilateral instrument[54] that will be developed[55] in 2016 or a combination of the two.

54 The multilateral instrument is a tax treaty that many countries could sign amending certain provisions of existing bilateral treaties. Canada is actively participating in the OECD's work to develop the multilateral instrument.
55 The OECD published the multilateral instrument on November 24, 2016.

APPENDIX XIII: SPONTANEOUS EXCHANGE OF TAX RULINGS

The lack of transparency in connection with certain tax rulings provided by tax authorities was identified as an area of concern by the BEPS project. This lack of transparency can give rise to mismatches in tax treatment and instances of double non-taxation.

The BEPS project proposes a minimum standard consisting of a spontaneous exchange framework covering six categories of rulings: (i) rulings related to preferential regimes; (ii) cross-border unilateral advance pricing arrangements; (iii) rulings giving a downward adjustment to profits; (iv) permanent establishment rulings; (v) conduit rulings; and (vi) any other type of ruling agreed to in the future.

In its 2016–2017 budget, the Canadian government confirmed its intention to implement the BEPS minimum standard for the spontaneous exchange of certain tax rulings.[56] In 2016 the Canada Revenue Agency will begin exchanging tax rulings with other agencies that have also committed to complying with the minimum standard.

Any information exchanged will, however, be subject to the confidentiality provisions in the relevant agreement, as is the information the Canada Revenue Agency currently exchanges under tax treaties, tax information exchange agreements and the Convention on Mutual Administrative Assistance in Tax Matters.[57]

56 The spontaneous exchange of tax rulings, it should be noted, differs from the automatic exchange of tax information. The former concerns rulings by tax authorities while the latter refers to the exchange of taxpayer information.

57 This convention is to help governments ensure compliance with their tax laws and provide a legal framework for cooperation between countries in fighting international tax evasion and fraud. It offers a range of tools for mutual administrative assistance in tax matters. It promotes all forms of information exchange, recovery assistance, document service, joint audits and information sharing. It safeguards the rights of taxpayers and makes extensive guarantees on protecting the confidentiality of information exchanged. The operation of this self-standing multilateral convention is overseen by a coordinating body comprising the Parties to the Convention.

APPENDIX IX: MODIFICATION OF THE EXCEPTION TO THE ANTI-SURPLUS-STRIPPING RULE

Generally speaking, the paid-up capital contributed to a corporation by its shareholders can be returned to them tax-free. But when retained earnings in excess of paid-up capital are distributed to shareholders, the surplus is normally treated as taxable dividends that are, for non-resident shareholders, subject to a 25% withholding tax (unless reduced under an applicable tax treaty).

Canada’s *Income Tax Act* contains a rule (Section 212.1) that is intended to prevent a non-resident shareholder from entering into a transaction to extract free of tax (or “strip”) a Canadian corporation’s retained earnings (or “surplus”) in excess of the paid-up capital of its shares or to artificially increase the paid-up capital of the shares. These transactions, where applicable, are called “surplus stripping” (the surplus of the tax due is stripped) and subsection 212.1 is known as the anti-surplus-stripping rule. When applicable, the anti-surplus-stripping rule results in a deemed dividend to the non-resident or a suppression of the paid-up capital of the shares that would otherwise have been increased as a result of the transaction.

An exception to this anti-surplus-stripping rule is found in subsection 212.1(4). It applies where a Canadian corporation (the “Canadian purchaser corporation”) acquires shares of a non-resident corporation that itself owns shares of a Canadian corporation, and the non-resident disposes of shares of the lower-tier Canadian corporation.

Some non-resident corporations with Canadian subsidiaries have misused this exception by reorganizing the group with a view to qualifying for this exception, as part of a series of transactions designed to artificially increase the paid-up capital of shares of those Canadian subsidiaries.

The 2016–2017 budget measure aims to counter this misuse of the exception to the anti-surplus-stripping rule.

APPENDIX X: EXTENSION OF THE BACK-TO-BACK LOAN RULES TO FOUR OTHER SITUATIONS

The back-to-back loan rules aim to prevent taxpayers from interposing a third party between a Canadian borrower and foreign lender in an attempt to avoid the application of rules that would otherwise apply if a loan were made directly between the two taxpayers. In particular, the rules ensure that the amount of withholding tax in respect of a cross-border interest payment cannot be reduced through the use of a back-to-back arrangement.

Back-to-back rules for rents, royalties and similar payments

Part XIII of the Income Tax Act imposes a 25% withholding tax on cross-border payments of rents, royalties or similar payments (collectively referred to as "royalties") made by Canadian-resident persons to non-residents. This 25% withholding tax rate is often reduced by a tax treaty. Given that not all tax treaties negotiated by Canada provide the same withholding rates and that some countries do not have a tax treaty with Canada, there is an incentive for some taxpayers to interpose, between a Canadian-resident payer of royalties and a non-resident payee, an intermediary entity located in a favourable tax treaty country.

Federal budget 2016–2017 proposes to extend the basic concepts of the back-to-back loan rules to royalty payments. Where they apply, the proposed rules for royalty payments will deem the Canadian-resident payer to have made a royalty payment directly to the ultimate non-resident recipient, and the amount of withholding tax avoided as a result of the back-to-back arrangement will become payable.

Similar to the existing back-to-back loan rules, the proposed rules for royalties will consider two arrangements to form a back-to-back arrangement if the Canadian resident makes a royalty payment in respect of:

- A lease, licence or similar agreement (the "Canadian leg") to a person or entity resident in a tax treaty country (referred to as the "intermediary") and the intermediary (or a person or partnership that does not deal at arm's length with the intermediary) has an obligation to pay an amount to another non-resident person or

- An assignment or an instalment sale (the "second leg")

And if one of the following conditions is met:

- The amount that the intermediary is obligated to pay is established by reference to the royalty payment made by, or the royalty payment obligation of, the Canadian-resident person, or by the fair market value of property where a right to use the property is granted under the Canadian leg

- It can reasonably be concluded that the Canadian leg was entered into or permitted to remain in effect because the second leg was, or was anticipated to be, entered into

This measure will apply to royalty payments made after 2016.

Character substitution rules

The back-to-back loan rules contemplate a loan between a Canadian-resident person and an intermediary in combination with a loan between the intermediary and another non-resident person. Similarly, the proposed back-to-back rules for royalties involve a combination of two agreements that relate to royalty payments. However, in each case, arrangements that provide payments that are economically similar to interest or royalty payments can be substituted between the intermediary and the other non-resident person.

Budget 2016–2017 proposes to extend the back-to-back rules to prevent their avoidance through the substitution of economically similar arrangements between the intermediary and another non-resident person. Specifically, a back-to-back arrangement may exist in situations where:

- Interest is paid by a Canadian-resident person to an intermediary, and there is an agreement that provides payments in respect of royalties between the intermediary and a non-resident person
- Royalties are paid by a Canadian-resident person to an intermediary, and there is a loan between the intermediary and a non-resident person
- Interest or royalties are paid by a Canadian-resident person to an intermediary, and a non-resident person holds shares in the intermediary that include certain obligations to pay dividends or that satisfy certain other conditions

Under these proposed character substitution rules, a back-to-back arrangement will exist where a sufficient connection is established between the arrangement under which an interest or royalty payment is made from Canada and the intermediary's obligation. This measure will apply to interest and royalty payments made after 2016.

Back-to-back shareholder loan rules

The shareholder loan rules generally apply where a shareholder of a corporation owes a debt to the corporation. The rules specifically apply when the debt remains outstanding for more than one year after the end of the corporation's taxation year. In such cases:

- Either the amount of the debt is included in the shareholder's income on the basis that such debt is, in substance, equivalent to a distribution of the corporation's profits;
- Or an amount determined by reference to a prescribed rate is included in the shareholder's income as a shareholder benefit.

Where the shareholder is a non-resident, these inclusions are deemed to be dividends subject to withholding tax under Part XIII of the Income Tax Act.

In situations where the shareholder loan rules would otherwise apply, there is an incentive to use a back-to-back arrangement to avoid their application by interposing a third party (that is not connected to the shareholder) between the corporation and its shareholder, in order to avoid the income inclusion or withholding tax.

To address the use of back-to-back arrangements to circumvent the shareholder loan rules, Budget 2016–2017 proposes to amend the shareholder loan rules to include rules that are similar to the existing back-to-back loans rules, except that the proposed rules will apply to debts owing to Canadian-resident corporations rather than debts owing by Canadian-resident taxpayers.

If the proposed rules apply, the shareholder will be deemed to be indebted directly to the corporation. A back-to-back shareholder loan arrangement will be considered to exist where a particular person or partnership (referred to as the "intermediary"), that is not connected with the shareholder, is owed an amount (the "shareholder debt") by the shareholder (or a person or partnership that is connected with the shareholder or that is a member of a partnership that is a shareholder), and one of the following two conditions is met:

- The intermediary owes an amount (the "intermediary debt") to the Canadian-resident corporation and either recourse in respect of the intermediary debt is limited to amounts recovered by the intermediary on the shareholder debt, or it can reasonably be concluded that the shareholder debt became owing because the intermediary debt was or was anticipated to be entered into.

- The intermediary has a right in respect of a particular property that was granted by the Canadian-resident corporation and either the existence of the right is required under the terms of the shareholder debt or it can reasonably be concluded that the shareholder debt became owing because the right was or was anticipated to be granted.

This measure will apply to back-to-back shareholder loan arrangements as of Budget Day, i.e., March 22, 2016. For back-to-back shareholder loan arrangements that are in place on Budget Day, the deemed indebtedness will be deemed to have become owing on Budget Day.

Multiple-intermediary structures

The existing back-to-back loan rules in Part XIII of the Income Tax Act apply to back-to-back financing structures that involve a single intermediary that borrows funds from a non-resident person and in turn makes a corresponding loan to a Canadian resident (as well as certain financially equivalent arrangements). The manner in which the rules apply to multiple-intermediary structures is not entirely clear.

Budget 2016–2017 proposes to clarify the application of the existing back-to-back rules to arrangements involving multiple intermediaries.

Under these proposed rules for multiple-intermediary structures, a back-to-back arrangement will comprise all the arrangements that are sufficiently connected to the arrangement under which a Canadian resident makes a cross-border payment of interest or royalties to an intermediary. The presence of such a connection will be established by applying similar tests to those that are used to establish a sufficient connection in a single intermediary context. Where a back-to-back arrangement involving multiple intermediaries exists, an additional payment (of the same character as that paid by the Canadian resident to the first intermediary) will be deemed to have been paid directly by the Canadian resident to the ultimate non-resident recipient in a chain of connected arrangements.

The proposed rules for back-to-back arrangements involving multiple intermediaries will also apply to back-to-back royalty payment arrangements and back-to-back shareholder loan arrangements.

This measure will apply to payments of interest or royalties made after 2016 and to shareholder debts as of January 1, 2017.

APPENDIX XI: PROVINCIAL CORPORATE TAX RATES, 2016

PROVINCE OR TERRITORY	LOWER RATE (%)	HIGHER RATE (%)
Alberta	3	10
British Columbia	2,5	11
Prince Edward Island	4,5	16
Manitoba	0	12
New Brunswick	4	12
Nova Scotia	3	16
Nunavut	4	12
Ontario	4,5	11,5
Québec	6,85	11,9
Saskatchewan	2	12
Newfoundland and Labrador	3	14
Northwest Territories	4	11,5
Yukon	3	15

Sources :

http://www.revenuquebec.ca/fr/entreprises/impots/societes/assujetissement/tauximposition.aspx

http://www.cra-arc.gc.ca/tx/bsnss/tpcs/crprtns/rts-fra.html

APPENDIX XII: KEY ANTI-ABUSIVE TAX PLANNING MEASURES IN QUÉBÉC

- Establishment of a mandatory disclosure requirement for transactions resulting in a benefit to the taxpayer of $25,000 or more, or having an impact on the taxpayer's income of $100,000 or more. Failure to comply with this regulation by the set deadline[58] exposes the taxpayer to a penalty of $10,000 to $100,000.
- Suspension, until disclosure is made, of the period of limitation applicable to the tax consequences arising from the undisclosed transaction.
- Establishment of new consequences in cases where the General Anti-Avoidance Rule (GAAR[59]) applies to an undisclosed transaction. The new consequences include the following:
  - The normal period of limitation for application of the General Anti-Avoidance Rule by Revenu Québec is increased by three years.
  - The taxpayer is subject to penalty equal to 25% of the additional tax resulting from the application of the General Anti-Avoidance Rule.
  - The promoter of the transaction is subject to a penalty equal to 12.5% of the amounts receivable by the promoter for the transaction.
- Establishment of a preventive disclosure mechanism allowing the taxpayer to avoid these new consequences.[60]
- Following the March 20, 2012 budget speech, tax legislation was amended so that a non-Canadian resident *inter vivos* trust is now required to file a tax return for each taxation year in which it owns a rental property in Québec, whether or not the trust owes taxes for the year.
- In the November 20, 2012 budget speech, it was announced that a trust subject to Québec taxation but required to file a tax return in certain circumstances must now file one if it meets the following criteria:
  - It allocated income to a beneficiary, irrespective of the beneficiary's place of residence.
  - It resides in Québec and owns property whose total cost exceeds $250,000.
  - It does not reside in Québec and owns property used to carry out a business in Québec whose total cost exceeds $250,000.

58 The mandatory disclosure deadline is the due date for filing the taxpayer's tax return for the taxation year in which the transaction resulting in the tax benefit or having an impact on the income occurred.
59 As at the federal level and in other Western nations.
60 The preventive disclosure deadline is the due date for filing the taxpayer's tax return for the taxation year in which the transaction began.

APPENDIX XIII:

RESOLUTION OF THE NATIONAL ASSEMBLY OF QUÉBEC

THAT the National Assembly condemn the tax haven practices that deprive the Québec State of considerable sums and violate the principle of tax equity;

THAT the National Assembly recall that all taxpayers must pay their fair share of taxes;

THAT the National Assembly ask the Federal Government to collaborate with the Québec Government to put an end to the tax avoidance perpetrated through the many offshore companies set up in Barbados by Canadian companies, in particular by amending Subsection 1 of Section 95 of the federal *Income Tax Act* and Section 5907 of the *Income Tax Regulations*, so as to specify that any company entitled to a special tax advantage granted by Barbados is not exempt from paying tax because of a tax treaty, in accordance with the Canada-Barbados *Income Tax Agreement*, 1980.

TRUE COPY OF THE MOTION UNANIMOUSLY ADOPTED BY THE NATIONAL ASSEMBLY ON APRIL 14, 2016.

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