Canada – TaxMatters@EY

April 2018

In this issue

TaxMatters@EY is a monthly Canadian bulletin that summarizes recent tax news, case developments, publications and more. For more information, please contact your EY advisor.

Is diversity part of your technology strategy?

As we move into an age of artificial intelligence, tech teams have to strive to eliminate bias in their AI apps.

Martin Fiore, EY Americas Tax Talent Leader, and Karyn Twaronite, EY Global Diversity & Inclusiveness Officer

The following article appeared in Information Week, 5 January 2018.

When innovations in intelligent automation elevated robotics from factory machines that work *alongside* people to smart machines that work *with* people, organizations began exploring the potential benefits from both an internal and external perspective.

The introduction of robotic process automation (RPA) and artificial intelligence (AI) has continued to advance to other technologies over time; however, RPA was a great place to start the human/machine collaboration, as it's a low-risk, relatively low-investment technology. RPA features software robots – more commonly referred to as bots – that can be programmed to mimic specific human actions, such as data retrieval needed for tax compliance or financial statements, at high speeds and with great efficiency.

The repetitive, mundane activities which bots do best just happen to be the least appealing tasks for millennials, freeing up talent to focus on more strategic, value-added and purposeful work. Previously untapped talent in less visible ranks and roles that had not yet had the time or platform to innovate as much now emerge. A win-win.

How talent drives strategy

Co-botting, humans and robots working together, obviously presents a number of benefits. But it presents an interesting challenge: how do businesses ensure implementation of new technology tools align with key talent objectives, such as skills training, leadership development and diversity and inclusiveness (D&I)?

The first two might seem obvious, but D&I, perhaps not so much. In truth, robotics and AI affect every layer of the D&I spectrum, from programming technology tools without amplifying biases to leveraging them to optimize the business benefits of D&I through recruiting, learning and teaming.

A recent article in *Science Magazine* highlighted the potential hazards of AI, noting that when algorithms learn words from human input, they develop biases of their own. And research with Implicit Association Tests (IATs) shows that bots are susceptible to learning their own set of stereotypes from their human programmers. An IAT is a psychological testing tool that flashes images on a screen, enabling people to react to the images they see and thereby reveal subconscious associations. In this case, the programmers unconsciously linked men with analytical and mechanical skills and women with child care and homemaking chores, for instance.

In his book, *The Future of Work*, author Jacob Morgan advises strategy before technology. Implementing a talent-focused strategy before intelligent automation helps companies avoid pitfalls inherent in designing machines to mimic human capabilities. When there is increasing automation, D&I become critical enablers to ensure that we are mitigating biases in the development, and minimizing inequities and inaccuracies in usage and impact.

Simply put, diverse teams allow organizations to uncover blind spots, see around corners and readily identify unintended biases. Incorporating diverse and inclusive thinking within a team feeds more robust automation and, conversely, that automation promotes best-in-class D&I objectives.

We have more to learn

Recognizing that we are still early in our journey, organizations should be diligent about acknowledging the "known unknown" — that threats of potential bias always lurk in the background — which can be done by:

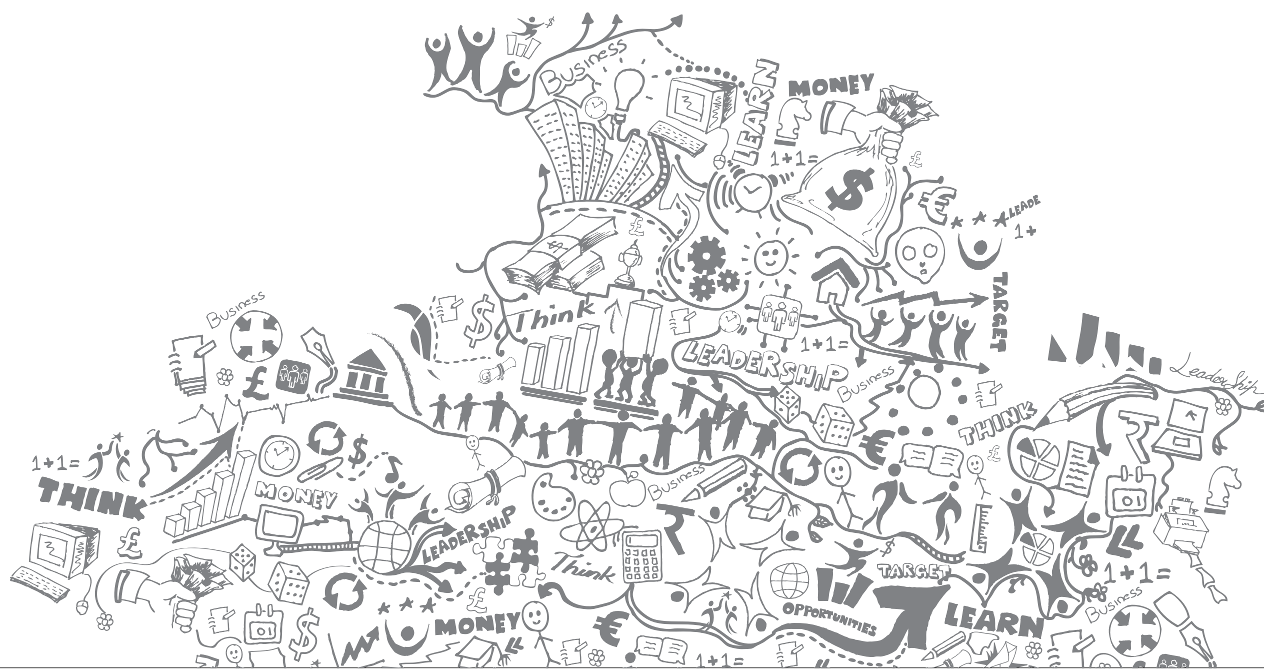
- Introducing organization-wide, overarching D&I reviews with technology as a factor
- Conducting formal reviews of new automation programs with an eye on factors relevant to the local market context, while staying consistent with the organization's core values
- Introducing an outside perspective to aid in the creation and review of bot programming, to bring in an objective arbiter of what constitutes unbiased programming

As with most things in business, these decisions often come down to strong leadership, unshakeable commitment and constant focus on everything that matters most to sustaining the organization's purpose and its business objectives. Technology is not neutral, and it's our responsibility to make it positive.

To that end, we offer four principles of a strong D&I technology strategy:

1. Stay alert to potential bias or to the alienation of our people.
2. Prevent machines from "inheriting" human bias and passing it along to future generations of technology tools.
3. Manage the relationship between people and changing technologies, particularly in establishing and maintaining trust, and the long-term effect that technology may have on shaping human behaviors.
4. Actively listen to professionals to gauge their sense of belonging.

This next stage will be exciting and filled with opportunities. Being proactive and mindful of the intersection between automation and D&I as we progress along this journey will allow organizations to stay connected with their people and continue to reinforce business strategies — with people front and centre.



The tax authority of the future: data analytics are coming

The following article is excerpted from EY's "The tax authority of the future: how tax authorities are using analytics to deliver new levels of value"

Starting on 1 January 2015, taxpayers in Russia were required to submit value-added tax (VAT) transactional data along with their electronic VAT returns. That year, domestic VAT revenues increased by more than 12%, the equivalent of around US$4 billion (RUB267 billion). Was an improving economy the cause? Perhaps more likely is the fact that the Russian Federal Tax Service had delivered on its vision for a nationwide VAT analytics platform.

Research from organizations such as the Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF) estimates that governments worldwide are losing billions of dollars in tax revenue each year through noncompliance, evasion, fraud and non-collection.

The experience of the Russian tax authority provides one example to illustrate the enormous potential of advanced analytics in tax administration. Using various statistical and data-mining technologies to identify anomalies, suspicious relationships and patterns, tax agencies can address a wide spectrum of noncompliance behaviors in a proactive, targeted and cost-effective way.

Many tax authorities have invested in digitalization, data integration and analytics. Several have already improved service, administration and compliance. However, much still needs to be done to leverage analytics as a standard practice across tax-related activities. A number of challenges remain, from technical, organizational and financial issues to legal and cultural concerns.

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How are tax authorities seeking to overcome these challenges and realize value through advanced analytics? In our discussions with progressive tax authorities, we have observed a number of steps being taken to transform into an analytics-driven tax authority.

An important starting point is having a clear vision of desired business outcomes and an analytics strategy that aligns with the broader organizational goals. Once the strategy has been defined, the leading tax authorities are selecting the most appropriate operating model for their analytics program.

As with any transformation driven by new or emerging technologies, writing the algorithms that can detect risk is not the greatest challenge. It is far harder to establish – and sustain – an organizational model that allows analytics to not only flourish but also become embedded in a tax authority's day-to-day operations.

We have identified six key factors adopted by leading tax authorities that underpin a successful analytics operating model by effectively aligning people, processes and technology:

- Fostering senior, board-level support within the tax authority, and appointing an influential executive to lead the analytics program across the enterprise
- Creating a talent management strategy that builds the right mix of skills and experience – IT, statistical, analytical and tax domain knowledge – needed to drive informed decision-making
- Tackling cultural barriers by promoting the use of analytics through formal change management programs, centres of excellence or dedicated teams that spread initiatives across the organization
- Experimenting with small-scale pilots to develop the proof of concept before rolling out analytics more widely
- Developing a single view of the taxpayer by creating an integrated information and communications technology (ICT) infrastructure that combines, transforms and consolidates data from a wide range of sources
- Actively managing data, including quality monitoring and correction processes, to verify that it is fit for purpose and, crucially, relevant to the business questions posed

By focusing holistically on these factors, leading tax authorities are better placed to realize value from their analytics programs.

They can reduce losses from criminal attacks, tax evasion and avoidance; make it easier for taxpayers to comply; develop strategies to "nudge" taxpayers toward compliant behaviors; allocate their resources more efficiently; and maximize returns from their debt management activities.

How data analytics can be, and are being, used to support tax authority transformation

Governments are losing significant revenue every year through nonpayment of taxes. According to the OECD,[1] countries are increasingly striving to measure the tax gap: 43% of revenue bodies say they are researching estimates of the aggregate tax gap for some or all of the major taxes. The resulting figures demonstrate the sheer scale of fraud, evasion and noncompliance and their impact on the growth of individual countries and on the world economy as a whole.

At the same time, the challenges in detecting and preventing fraud and noncompliance are intensifying. The increase in cross-border and internet-based transactions, the emergence of the sharing economy and disruptive technologies, more mobile populations, and changing employment patterns and lifestyles are just a few of the factors that are contributing to a more complex operating environment for tax authorities. The existence of divergent tax systems and procedures in different countries creates an opportunity for tax fraud and noncompliance, especially where there is a lack of cooperation and communication between tax authorities. And with criminals using increasingly complex and sophisticated fraud schemes to circumvent tax rules, the task of promoting compliance is only getting harder.

How the CRA uses data analytics

The data analytics discussed in this article are rapidly becoming part of the tax landscape. The Canada Revenue Agency (CRA) has already begun to use advanced data techniques as part of its procedures. Consider the following recent comments of Diane Lebouthillier, Minister of National Revenue and of the CRA, on 19 February 2018 in response to a letter from the Offshore Compliance Advisory Committee (OCAC) outlining recommendations on the analysis of big data:

> "…The CRA already has sophisticated IT tools in place to analyze various data sources and will continue to take the necessary actions to improve its risk assessment processes and systems."

> "…The CRA continues to prioritize obtaining better data, improving its use of data to target its compliance actions and achieving results in its fight against offshore tax evasion and aggressive tax avoidance."

In response to Recommendation 4 of the OCAC letter, the CRA states:

The CRA also uses automated, rules-based risk assessment systems in its small- and medium-sized business audit programs. To complement these systems, the CRA is developing predictive models. These models use machine-learning techniques to identify potential areas of non-compliance by discovering unseen patterns in data.

…The CRA is implementing social network analysis to automate the identification of links between individuals and businesses. It is enhancing its suite of risk assessment tools to address the compliance risk associated with all taxpayer groups, including those using **offshore and aggressive tax planning**.

[1] Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies, OECD, August 2015.

Leveraging analytics to address tax authorities' most pressing challenges

At a time of heightened expectations for more transparent and accountable government, tax authorities are under political and public pressure to act. The media, non-governmental organizations, charities, special interest groups, trade unions, national audit offices and parliamentary committees are vocal about the need to crack down on tax fraud, evasion and overly aggressive avoidance to increase revenues and create a fairer tax system.

So what more can governments do? One answer lies in the ability to exploit the mountains of structured and unstructured data to which tax authorities have access. By using analytical techniques to identify anomalies and patterns, tax agencies can address a wide spectrum of noncompliance in a cost-effective way.

What has made this possible? Cheaper storage and advanced computing power are readily available, enabling the processing of large volumes of data in a digital format, regardless of size and complexity. The emergence of powerful and cost-effective analytical tools has also removed cost barriers and helped organizations unlock value from their data.

Tax authorities can recognize major compliance risks, such as intentional attacks on the tax system by organized criminal gangs; undeclared economic activity within the shadow economy; and deliberate tax evasion. They can also spot aggressive tax avoidance, where companies or individuals exploit the rules to gain an advantage that the government never intended – operating within the letter, but not the spirit, of the law.

Analytic models can help assess risks both before and after filing and identify taxpayers that are most likely to be noncompliant. Authorities can then target interventions at those believed to present the greatest risk, including "nudge" approaches that encourage voluntary compliance. The use of analytics can also make it easier for taxpayers to comply, as tax authorities implement service-oriented reforms that make filing easier, eliminate overlapping requests for information and deliver better-targeted services based on a deeper understanding of taxpayers' needs and behaviors.

Governments' overall spending has been under pressure since the financial crisis, and many tax authorities have seen reductions in their operating budgets and headcount at a time when they need to increase tax receipts. Through the use of analytics, tax authorities can allocate their resources more effectively in pursuing those who are noncompliant, and predicting where violations are likely to happen in the future. Some are using it in their debt management activities by modeling the likelihood that a taxpayer will repay the tax owed and identifying interventions that will yield the maximum return.

Big data and analytics defined

Data comes in many forms. It may be structured or unstructured, and it may be generated by organizations themselves or obtained from third parties. Big data refers to the huge and increasing volume of the data now available, as well as the variety of it and the velocity at which it can be processed.

Analytics is the means for extracting value from this data – the tool through which actionable insights are generated.

Without analytics, businesses have no way of using their big data to establish competitive advantage.

> "A risk-oriented approach means that audits are fewer in number and better targeted, which ultimately leads to a reduction of the administrative burden on those businesses that comply with the law."
>
> *Mikhail Mishustin, Commissioner of the Russian Federal Tax Service*

The capability to use big data and analytics for business advantage has existed for some time. Yet, like a number of private sector players, many tax authorities still struggle to fully capitalize on the opportunities.

Springing into action: driving value through analytics

With a strategic vision and supportive organizational model in place, leading tax authorities start to reap the benefits from data-driven decision-making.

The key to implementing analytics in tax authorities is consistent with the three stages of the EY Analytics Value Chain used across all types of business:

- **Manage data** – developing the tools and techniques to manage, extract and integrate relevant data from various sources
- **Perform analytics** – deploying analytical techniques, ranging from historical reporting to real-time decision support for the organization
- **Drive decisions** – using the insights generated by the analysis to inform evidence-based decision-making; and to assess the impacts of actions and interventions, thereby creating a continuous feedback loop for performance improvement

Manage data

To combat evasion and noncompliance, and to make it easier for taxpayers to comply, leading tax authorities develop a detailed understanding of taxpayer behavior. They can develop a fuller picture by linking customer data held internally and enriching it with information from external sources, such as media reports and financial transactions.

Integrate existing data to create a single view of a taxpayer's activities

Tax authorities administer tax regimes that have evolved over decades, even centuries, and their organizational structures, processes and technology have evolved in parallel, creating silos across the business. To effectively leverage analytics, leading authorities link data on customers' interactions with each tax regime to produce a single view of the taxpayer, based on one unique identifier for each.

Once the data has been cleansed and linked, it can be stored in various ways. In the last few decades, data warehouses (which incorporate structured data such as tax databases) have been built specifically for this purpose. In the last few years, large organizations have adopted data lakes, which can hold many types of both structured and unstructured data. At the same time, powerful frameworks such as Apache Hadoop can distribute the storage and processing of data across clusters of computers, enabling tax authorities to exploit big data. The Australian Taxation Office, for instance, as part of its Smarter Data Project, has tested a Hadoop-based Enterprise Data Hub consisting of five virtualized servers.

Enrich the single customer view with information from a broad variety of sources

The data available to tax authorities is expanding rapidly as they gain access to more comprehensive and granular information from third parties to develop a more complete picture of taxpayers' profiles. Some governments are legislating to extend their powers to obtain information from an ever wider range of sources. The UK Government, for example, extended HMRC's data-gathering powers to include business intermediaries and electronic payment providers – similar to what is seen in Australia.

Companies are increasingly being asked to submit client invoices (typically in electronic form), statements of account, customs declarations, vendor invoices and bank records. Tax authorities are also asking companies to provide files directly from corporate accounting systems that align with a predefined standard for electronic exchange (the OECD's Standard Audit File for Tax, or SAF-T, is gaining traction in Europe).

Recent international developments have made it easier for tax authorities to share information, carry out joint risk assessments and compare taxpayers' declarations. The OECD initiatives on the common reporting standard (CRS) and on base erosion and profit shifting (BEPS) demonstrate this more cooperative approach to data exchange. All these disparate sources have a place in a tax authority's business intelligence strategy.

An enhanced capability to manage unstructured data creates further opportunities to enrich the customer view by making better use of relevant data, such as intelligence reports; communications data from surveillance operations; and "open source" data from news media, social network feeds and third-party electronic sales platforms.

Perform analytics

While the data and technology platforms are crucial, what drives business value is the ability to frame the right questions and focus the analysis on answering them. Leading tax authorities first determine what they are trying to achieve. Then they must consider which analytic techniques can help answer their questions given the data available.

"There's a 'sophistication spectrum' for data analytics: 'reporting' – what happened; 'understanding' – why it happened; 'identifying' – given a known risk, identifying who this might apply to; and 'predicting' – using analytics to find new and emerging risks."

Robert Ravanello, Deputy Commissioner, Service Delivery, Australian Taxation Office

The variety of analytics techniques available enables tax authorities to identify historical and recently noncompliant customers for investigation and follow-up, and to flag customers at higher risk of future noncompliance.

Identifying historical and recent noncompliance for investigation and scrutiny

With tax authorities' resources under pressure, leading tax authorities are looking to more effective methods to target noncompliant or fraudulent activity, and to make it easier for taxpayers to comply.

Linking records to create a single customer view enables tax authorities to cross-reference information supplied on tax returns with data from other sources (such as employers, financial institutions and other government agencies). They can detect errors, discrepancies in stated income and potential fraud.

Business rules are used mainly to identify known fraud and compliance risks. If a tax authority is encountering certain repetitive problems, it can create a business rule that will trigger an alert on matching fact patterns and highlight whether any action is needed.

Anomaly detection techniques highlight relationships, behaviors and events that deviate from the standard – a way to identify potential new fraud and compliance risks. Techniques such as statistical outlier detection and cluster analysis uncover anomalies in customer behavior and circumstances. Anomaly detection can also examine changes over time to pinpoint a deviation from a historical pattern, possibly indicating fraud.

The "nearest neighbor" approach is commonly used to compare a taxpayer's return with those of peers – for instance, in a particular sector – to identify outliers or unusual cases for further investigation.

Social network analysis, or "link analysis," uncovers hidden or unexpected relationships that indicate collusion across suspect groups or organized fraud rings. It is based on linking "entities" in the data (for instance, individuals, businesses, mobile phone numbers and bank accounts) using transactional information – such as utility bills, newspaper reports and phone records collected during criminal investigations – to identify potential criminality across networks of individuals and businesses. Tax authorities can profile individual risk or create a risk-scoring model for the network through rules-based assessments or statistical modeling. The technique is very effective at identifying VAT carousel fraud, for example.

Identifying taxpayers at higher risk of future noncompliance

Predictive analytics capable of identifying high-risk customers can give a high return on investment because the tax authority can formulate the right strategy and take action before the event has happened, preventing losses and improving revenue recovery.

Predictive modeling uses historical information to build models that identify behaviors, attributes or patterns that correlate with known or emerging patterns of noncompliance. The models are used to create risk scores for existing taxpayers, as well as for new taxpayers and dealers. Techniques can be divided into either statistical models, such as regression, or machine-learning algorithms, such as decision trees and neural networks.

Text mining can help tax authorities scan and identify phrases, patterns and entities in different sources of unstructured data – newspapers, videos, social media posts, etc. – using techniques such as natural language processing and sentiment analysis.

It can improve predictive models by updating risk scores and determining the probability of future noncompliance through the use of more dynamic information.

Using data insights to drive decision-making

While the different analytic techniques can provide insights on key business questions, the real value lies in using those insights to drive decisions. Analytics can improve decision-making and generate benefits on a number of levels: the individual tax caseworker, the business unit, the tax authority and the wider government.

The tax caseworker

Analytics can influence decisions on which cases to prioritize based on the risk associated with different groups and individuals.

Analytics is most effective at this level when it is incorporated into the technology and business processes used by staff – for example, through the display of risk scores in case management systems. But it requires training the tax staff on how to use the scores in the broader prioritization and treatment of individual cases.

Analytics also helps drive decisions on the appropriate treatment strategies for different taxpayers. For example, audits and penalties are a fitting response to deliberate tax evasion, but education and assistance may be more appropriate when taxpayers have simply misunderstood the law. In some less-developed countries, tax authorities take a harder line on compliance, believing that violations are usually deliberate. Risk analysis can help shift the mindset of tax caseworkers so they better understand the reasons for noncompliance and take a more customer-centric approach to foster voluntary compliance.

The business unit

Analytics is used to understand emerging trends and identify noncompliance risks that may result from revised business models, economic shifts or legislative changes. For example, tax authorities can use analysis to assess emerging trends and threats, and establish a stronger presence in those sectors through enhanced audits and verification activities, such as targeted inspections. Analytics also helps business units develop better-targeted services and optimize interventions for different groups. By analyzing operational results, business units can continuously improve their compliance programs and activities through more tailored responses and appropriate allocation of resources.

The tax authority

At the organizational level, analytics can be used for decision-making on strategy and policy, including more precise measurement of the tax gap and assessments of how changes in tax policy are likely to affect citizens and businesses. Data visualization and simulation modeling are particularly useful in determining the impact of policy changes.

Analytics can also help identify ways to enhance taxpayer services: for example, by improving service design, informing decisions on channel strategies, and delivering focused outreach and communication programs to help taxpayers understand their responsibilities. Some tax authorities are using behavioral economics techniques to design "nudge" campaigns that influence behavior to improve compliance and uptake of e-services. These include, for example, writing businesses to advise them of common errors; providing in-person assistance with compliance; and working with industry associations to raise awareness and promote compliance.

"Risk differentiation allows us to develop other strategies to support the system, including through customer communications, improving participation and nudge-type strategies."

David Allen, Assistant Commissioner, Internal Engagement and Transparency, Australian Taxation Office

Many national tax authorities are choosing to be more open around the positive results they are achieving with analytics, in the hope that sharing such results will spur higher levels of future compliance. "Taxman unleashes its 'snooper computer': what information does it have on you?" read the headline of one article in the UK media in January 2017. This illustrates a growing trend for revenue authorities to publicize their analytics activities to reinforce the need for compliance. With tax avoidance capturing so much media attention, tax authorities are seeking to balance the need for secrecy with the benefits of openness.

The government

Policymakers can use the results from analytics to provide insight and advice to the treasury or the finance ministry on the development of tax policy. "What if" scenario modeling allows officials to assess the effects of tax regime changes from both a treasury perspective (tax receipts) and a social and political perspective (impact on customer groups). Analytics-based forecasts of the impacts of tax changes can be incorporated into "system dynamics" models of the whole government, helping policymakers understand knock-on effects at a national level. Many tax authorities are responsible not just for tax administration, but the provision of other services or benefits through the tax system. They find themselves playing a role of "data broker," sourcing data from many other government departments (such as immigration, pensions, social security and property registries, to name but a few) and also providing valuable evidence in support of criminal activities in return.

But while "joined up" government has been a widespread goal for some time, the rapid rise of big data activities does bring potential risks that must be carefully assessed. Data privacy and confidentiality issues must be supported by not only the appropriate legislation, but also the utmost care when it comes to data transfer. More than one national tax authority has learned this lesson the hard way.

Moving forward

Data analytics will play a key role in every tax administration in the future, supporting the human judgment that tax officers bring to decision-making. It will drive efforts to tackle tax evasion, identify overly aggressive tax avoidance and support debt management techniques. It will allow tax administrators to focus their limited resources far more effectively on areas such as promoting cooperative compliance and influencing taxpayer behavior. And it will sit at the heart of managing disruptive new forces such as the shared and "gig" economies and contingent-working methods. At the same time, data analytics also provides the opportunity for tax administrations to improve services to taxpayers, reducing the burdens of compliance.

Many tax authorities are already exploring the next steps for proactive, rather than reactive, analytics. But acquiring, programming and operating the technology needed to support an analytics strategy are just one part of a complex puzzle. Many other pieces are equally important: gaining support from the top; developing the right governance model; making certain that analytics deliverables are embraced and utilized on the front lines; and adjusting the talent model.

Becoming an analytics-driven tax authority is a transformational journey that requires a holistic approach across various pillars – strategy, organization, process, technology and people.

Significant benefits await organizations that overcome the challenges and harness the enablers of change.

The tax of the moment: indirect tax

Jay Nibbe, EY Global Vice Chair, Tax
Excerpted from EY's Tax Insights for business leaders No. 20

Indirect taxes are part of everyday life in many countries – we pay them on food, clothing, gasoline, vices such as alcohol and chocolate, and our mobile phones.

The levies have long been popular because governments don't have to wait for a business to generate a profit to collect a tax; all that needs to happen is for a transaction to occur. Going forward, technology will further boost their popularity as digitalization has positively impacted the administration of these taxes.

For consumers, value-added taxes (VAT) and goods and services taxes (GST) – present in more than 160 jurisdictions – are the most common and visible touch-points.

Businesses, however, must deal with a wide swath of indirect levies including excise taxes, customs duties, carbon taxes and more. And this list will continue to grow with the expansion of global trade as well as global trade agreements, adding more layers of complexity to the indirect tax compliance labyrinth.

In theory, the typical indirect taxes (VAT) are designed to be a cost to business only to the extent they are the end user of the good or service, with an offset or credit in their supply chain/production.

However, businesses must carefully manage these costs, as unclaimed VAT offsets or disputed VAT refunds could hurt profitability. In fact, businesses identified indirect taxes as their No. 2 overall source of risk in the most recent EY Tax Risk and Controversy Survey Series, behind only transfer pricing.

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The "go to" tax

The global taxation system is currently undergoing an unprecedented transformation, and indirect tax is well placed to become the "go to" source of tax revenue for governments in the future.

For example, countries around the world are currently implementing recommendations by the Organisation for Economic Co-operation and Development (OECD) to prevent so-called base erosion and profit shifting (BEPS) of income. These changes are expected to bring increased transparency but greater controversy as well. Taxation on profits will continue to be a highly disputed area, with the digital economy changing dynamics on "how" to tax.

The relative clarity of taxing transactions will only make indirect tax more attractive to policymakers and businesses that find themselves increasingly embroiled in disagreements over which profits are subject to tax and where. While the determination of how to assess indirect taxes in a digital economy has similar ambiguities, it is likely to be a growing source of revenue for governments.

Investing in the future

This is not to say indirect tax administration is perfect – far from it. Tax administrations in many jurisdictions struggle to deal with indirect tax fraud. The European Union, for example, estimates it lost €151.5 billion in VAT in 2015.

In response, tax administrations have established many complex and costly compliance requirements, and as a result businesses today often face substantial delays in obtaining VAT/GST refunds or credits. Others wind up receiving nothing, with some finding the compliance requirements so onerous that they don't even bother filing for refunds. Automation and technology promise to help businesses better manage the complex and often lengthy process of claiming indirect tax refunds.

But this will require businesses to invest in their own tax departments, including in the area of robotic process automation, in order to make the tax function more efficient and free up employees to focus on value-added activities. And investments in technology will support growing compliance demands created by new government initiatives that track VAT/GST-related transactions in real-time through e-invoicing, blockchain or other innovations.

Digital questions

Controversy may also be set to increase in the indirect tax space thanks to looming digital issues.

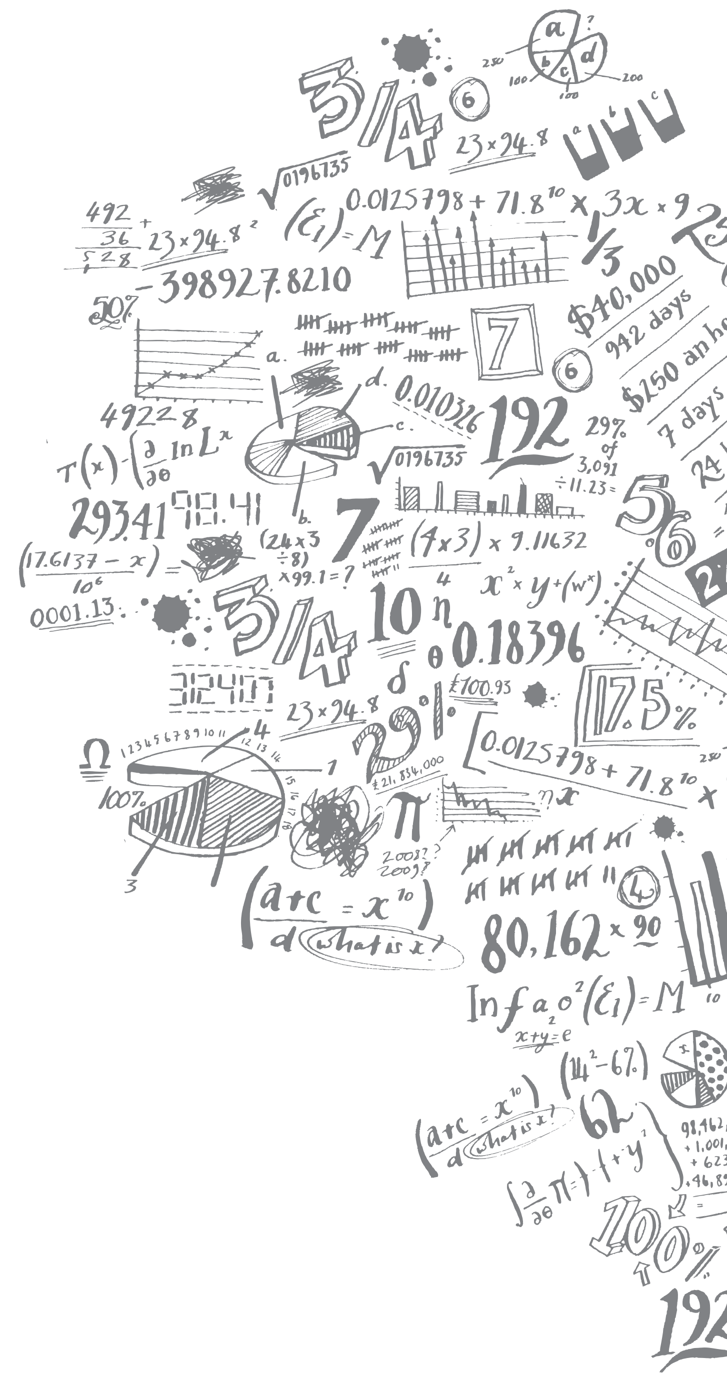
Just as in the income tax space, indirect tax officials are wrestling with fundamental questions and taking different approaches on what to tax and where in the digital economy.

Tax administrations are increasingly focused on collecting VAT/GST due from business-to-consumer as well as business-to-business digital transactions, adapting and introducing legislation to collect these indirect taxes in the country in which the consumer is based.

Changes in the approach to taxation of e-commerce transactions pose an increased risk of double taxation in the indirect tax space, something that historically was a bigger concern in the profit tax arena. Businesses need to keep up and comply with changing tax laws for digital transactions – an admittedly challenging task considering the current pace of change.

Investing in both people and technology will enable businesses to anticipate and resolve controversy and to monitor fast-changing developments in critical markets.

It's a new era for indirect taxation, and businesses need to prepare for this new landscape. In our globalized, digital world economy, indirect taxes are the tax of the moment.



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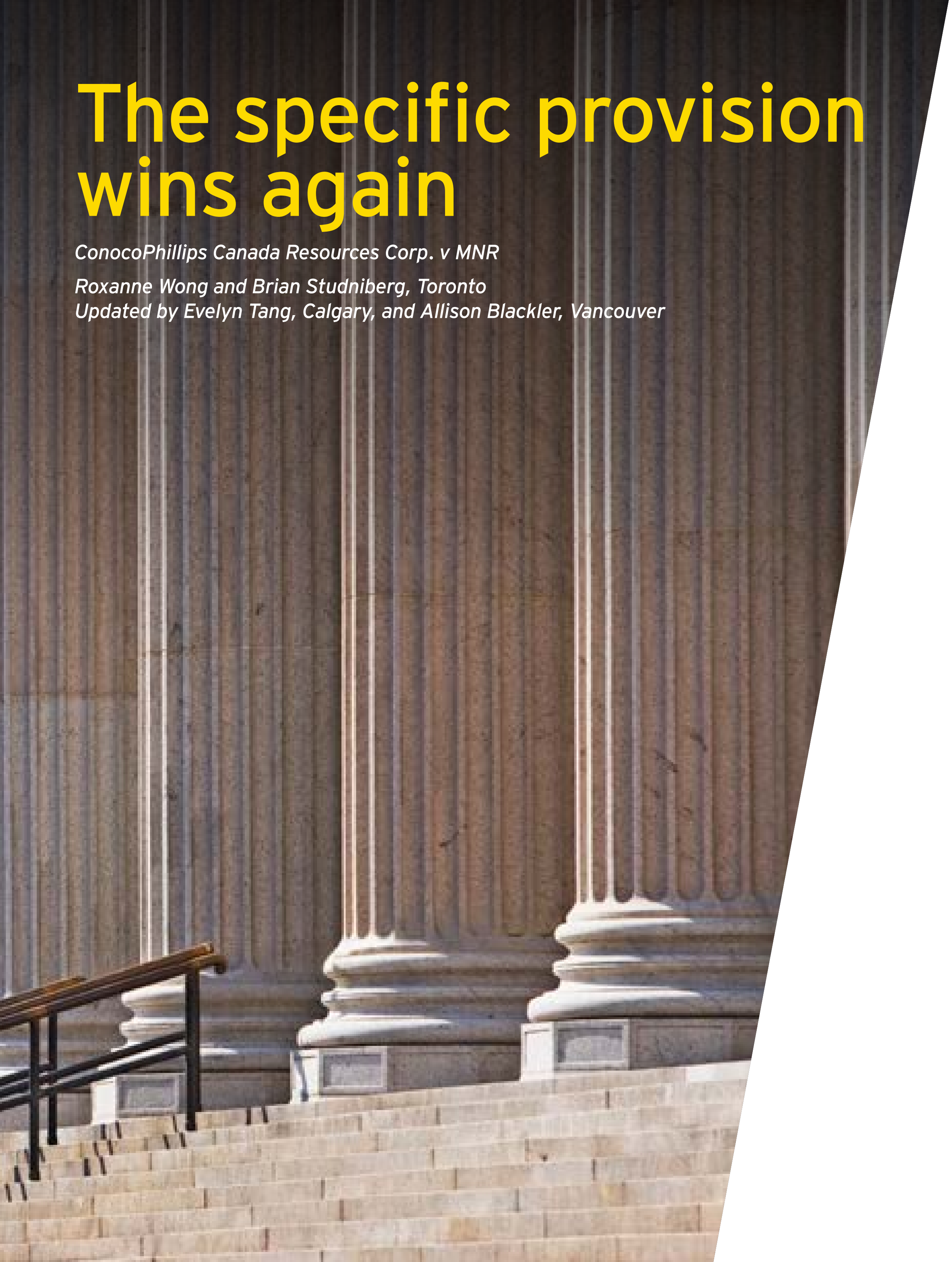
The specific provision wins again

ConocoPhillips Canada Resources Corp. v MNR

Roxanne Wong and Brian Studniberg, Toronto
Updated by Evelyn Tang, Calgary, and Allison Blackler, Vancouver



In the 2016 decision, *ConocoPhillips Canada Resources Corp. v MNR*, 2016 FC 98, the Federal Court (FC) concluded that the Minister of National Revenue (the Minister) may have the power to allow a taxpayer to file a notice of objection beyond the deadlines set out in the *Income Tax Act* (the Act) by virtue of subsection 220(2.1) of the Act, one of the "Taxpayer Relief Provisions," which are usually used to waive or cancel interest and/or penalties.

However, in *ConocoPhillips Canada Resources Corp. v MNR*, 2017 FCA 243, the Federal Court of Appeal (FCA) overturned that decision, on the basis that the specific provision addressing objection timelines overrules the more general discretionary relief provision.

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Facts

The taxpayer in this case participated in a project that was subject to a remission order[2] for the 2000 tax year. As the taxpayer and other participants did not agree with the Minister's calculations of the amounts remitted under the remission order, the taxpayer and the other participants brought an application for judicial review in this respect (referred to as the remission litigation). If the taxpayer was successful in the remission litigation, the taxpayer would receive additional income. As the 2000 tax year was becoming statute barred, the Canada Revenue Agency (CRA) requested a waiver from the taxpayer. The taxpayer refused to provide it. Thus, in a "protective assessment," the CRA assessed an amount of income to the taxpayer for the 2000 tax year in anticipation of the income (referred to as anticipatory income) that the taxpayer would stand to receive if it were successful in the remission litigation. In 2006, the taxpayer validly objected to the protective assessment that added the anticipatory income to the taxpayer's income for the 2000 tax year.

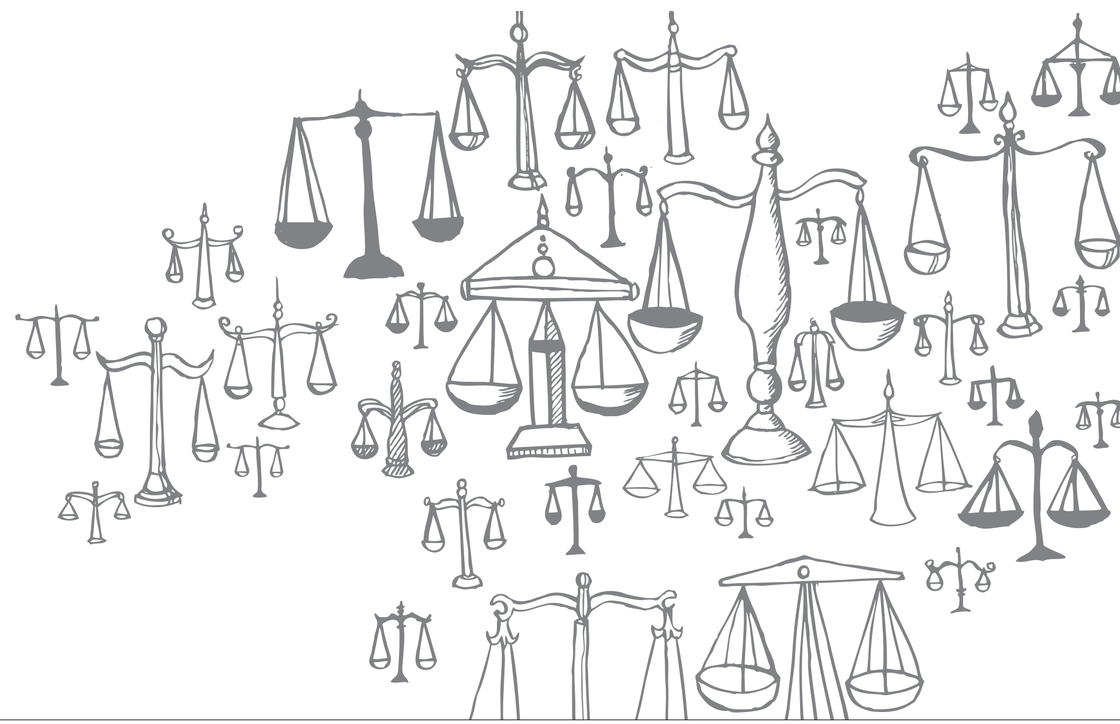
The taxpayer was not successful in the remission litigation which concluded in 2010 and, consequently, it sought to remove the anticipatory income that had been protectively assessed. Unfortunately, the taxpayer was not aware that the CRA believed there had been a subsequent reassessment issued in 2008 for the taxpayer's 2000 taxation year, unrelated to the anticipatory income. In the CRA's view, the subsequent reassessment nullified the prior assessment when the subsequent reassessment was issued in 2008 and, as a result, also nullified the taxpayer's objection at that time.

The taxpayer did not learn of the subsequent reassessment and the resulting nullification of its objection until 2010. The taxpayer then attempted to file a second notice of objection, to replace the one that it discovered had been nullified, but the CRA rejected it because, in the CRA's view, the second notice of objection had not been filed within the required timelines. More particularly, a corporate taxpayer only has 90 days to file a notice of objection in respect of an assessment under section 165 of the Act. If that deadline is not met, a taxpayer has one year from the expiration date for serving the objection to seek an extension of time to file the notice of objection under section 166.1 of the Act. The CRA took the position that, because the original objection had been nullified by the subsequent reassessment and a second notice of objection in respect of the subsequent reassessment had not been filed within the timelines under sections 165 and 166.1 of the Act, the taxpayer could not challenge the anticipatory income assessed.

The taxpayer then requested relief under subsection 220(2.1) of the Act, which provides that, where any provision of the Act requires a person to file a prescribed form, receipt or other document, or to provide prescribed information, the Minister may waive the requirement, but the person shall provide the document or information at the Minister's request. More particularly, the taxpayer's request was that the Minister waive the requirement to serve a notice of objection in the circumstances.

The CRA refused to grant relief on behalf of the Minister, on the basis that it did not have jurisdiction to grant the relief the taxpayer requested. The CRA's position was that subsection 220(2.1) of the Act cannot be used in the manner requested, as it would "read out" (i.e., make it possible to ignore) section 165 of the Act that requires the taxpayer to serve a notice of objection. If read out, the CRA would not have jurisdiction to reconsider an assessment and the Tax Court could not hear an appeal due to the lack of a notice. Further, the CRA argued that the Act provides a complete code for disputing assessments with limitation periods and specific provisions to extend time for late filing. According to the CRA, extending the time to object beyond these periods (which would be the effect of waiving the requirement to file an objection) would defeat the finality and fiscal certainty principles underlying these provisions. Moreover, if Parliament had intended to grant the CRA the ability to waive the requirement for a notice of objection, then the Act would expressly say so.

The taxpayer then applied for judicial review of the Minister's decision to the FC.



[2] A remission order is an extraordinary measure under the Financial Administration Act that allows the government to provide full or partial relief from a tax or penalty, or other debt, under certain circumstances, when such relief is not otherwise available under the existing laws.

Federal Court decision

The FC rejected the CRA's arguments. According to the FC, subsection 220(2.1) should, like all other federal legislation, be interpreted in a large and liberal manner consistent with its objects, rather than in a narrow and restrictive way. Further, the CRA's jurisdiction argument was unfounded, since subsection 220(2.1) requires the person to provide the document or information if the Minister requests, and therefore the Minister could still request that the taxpayer file the notice of objection.

Thus, the FC concluded that the CRA did have jurisdiction to grant the relief sought by the taxpayer under subsection 220(2.1) and referred the matter back to the CRA for reconsideration (since the FC does not have the jurisdiction to actually exercise the Minister's discretion under subsection 220(2.1)).

Federal Court of Appeal decision

The FCA overturned the FC's decision. In reaching this conclusion, the FCA first acknowledged that the modern rule of statutory interpretation requires that provisions be considered in their entire context, harmoniously with the object and scheme of the Act and the intentions of Parliament. The FCA observed that the Act set out a detailed regime for disputing assessments of tax, including the strict limits imposed under subsection 166.1(7) for granting extensions of time, and that any interpretation of subsection 220(2.1) must accord with that regime.

The FCA then considered the interplay between the discretionary relief set out in subsection 220(2.1) and the clear statutory intent of the objections scheme. In doing so, the FCA applied the "implied exception" statutory interpretation rule, described in *James Richardson & Sons, Ltd. v Minister of National Revenue*, [1984] 1 SCR 614:

> The rule, is that wherever there is a particular enactment and a general enactment in the same statute, and the latter, taken in its most comprehensive sense, would overrule the former, the particular enactment must be operative, and the general enactment must be taken to affect only the other parts of the statute to which it may properly apply.

The FCA observed that the regime for notices of objection is very detailed, with specific time limits, which are applied strictly. To allow the general waiver provision to override the specific time limits under the objection regime would grant the Minister a discretionary power that is otherwise expressly not permitted.

On that basis, the FCA concluded that the Minister was right to rely on the fact that a general provision will not override a more specific provision and, as a result, the Minister's decision was both reasonable and correct in denying the taxpayer's request.

Lessons learned

The earlier FC decision was certainly a broad interpretation of the Minister's discretionary powers under the Taxpayer Relief Provisions. This decision by the FCA rejects that broad interpretation and instead affirms that the Act contains a complete code for notices of objection, with no discretion open to the Minister under subsection 220(2.1) to waive those strictly imposed timelines.

This is now the fourth time that the taxpayer has been before a court in respect of this matter. (The prior two cases were *ConocoPhillips Canada Resources Corp. v MNR*, 2013 FC 1192 and MNR v *ConocoPhillips Canada Resources Corp*., 2014 FCA 297. These other decisions related to the taxpayer's attempt to reach its desired resolution through another avenue of pursuit.)

Taken together, these four cases illustrate how tax disputes may sometimes have more than one available path to reach a potential resolution. The two most recent cases emphasize how important it is for taxpayers to be aware of *what steps must be taken and when* to preserve their rights in respect of each option.

This may not be the end of the road for this taxpayer. As the FCA suggested, perhaps the taxpayer's next step will be to pursue yet another remission order, an option that is, after all, designed to provide relief for exceptional circumstances such as these.

Publications and articles

Tax Alerts – Canada

Tax Alert 2018 No. 10 Manitoba budget

Tax Alert 2018 No. 11 FCA reaffirms CIP outside litigation context

On 6 March 2018, the Federal Court of Appeal (FCA) rendered its decision in Iggillis Holdings Inc. v the Queen, relating to solicitor-client privilege. The FCA overturned the previous Federal Court decision and concluded that a legal memorandum was protected from disclosure to the Minister by solicitor-client privilege acknowledging common interest privilege (CIP) in a transactional context.

Tax Alert 2018 No. 12 Nova Scotia budget

Tax Alert 2018 No. 13 Alberta budget

Tax Alert 2018 No. 14 CPTPP agreement is signed

The Comprehensive and Progressive Trans-Pacific Agreement for Partnership (CPTPP) (formerly the 11-member *Trans-Pacific Partnership agreement* or TPP-11) was signed by its member states, including Canada, on 8 March 2018. The agreement covers a market of 495 million people with a combined GDP of CAD$13.5 trillion, or nearly 13.5% of global GDP.

Tax Alert 2018 No. 15 Newfoundland & Labrador budget

Tax Alert 2018 No. 16 Quebec budget

Tax Alert 2018 No. 17 Ontario budget

Tax Alert 2018 No. 18 - Quebec government announces QST and e-commerce measures

Through budget provisions presented on 27 March 2018, the Quebec government intends to implement a new mandatory specified registration system for suppliers with no physical or significant presence in Quebec to ensure the Quebec sales tax (QST) is collected and remitted in the context of the digital economy.

Publications and articles

EY's Global Capital Confidence Barometer

The 17th edition of EY's *Global Capital Confidence Barometer* finds that Canadian respondents are still firmly aiming to pursue acquisitions in the next 12 months, and are buoyed by positive momentum in the local and global economies.

EY's Worldwide Personal Tax and Immigration Guide 2017-18

This guide summarizes personal tax systems and immigration rules in more than 160 jurisdictions, including Australia, Brazil, Canada, France, Germany, Mexico, the Netherlands, the Russian Federation, the UK and the US.

EY's Worldwide Capital and Fixed Assets Guide 2017

The *Worldwide Capital and Fixed Assets Guide* helps our clients navigate the rules relating to fixed assets and depreciation. It summarizes the complex rules relating to tax relief on capital expenditures in 27 jurisdictions and territories.

EY's Worldwide Estate and Inheritance Tax Guide 2017

EY's Worldwide Estate and Inheritance Tax Guide summarizes the estate tax planning systems and describes wealth transfer planning considerations in 37 jurisdictions around the world, including Australia, Canada, China, France, Germany, Italy, the Netherlands, the UK and the US.

Worldwide Corporate Tax Guide 2017

Governments worldwide continue to reform their tax codes at a historically rapid rate. Chapter by chapter, from Afghanistan to Zimbabwe, this EY guide summarizes corporate tax systems in 166 jurisdictions.

Worldwide VAT, GST and Sales Tax Guide 2018

This guide summarizes the value-added tax (VAT), goods and services tax (GST) and sales tax systems in 122 jurisdictions, including the European Union.

Worldwide R&D Incentives Reference Guide 2017

The pace at which countries are reforming their R&D incentives regimes is unprecedented. This EY guide summarizes key R&D incentives in 44 jurisdictions, and provides an overview of the European Union's Horizon 2020 program.

2016-17 Worldwide Transfer Pricing Reference Guide

The proliferation of transfer pricing rules and regulations around the world, and the huge increase in focus on the subject by the world's tax authorities, require practitioners to have knowledge of a complex web of country tax laws, regulations, rulings, methods and requirements. This guide summarizes the transfer pricing rules and regulations adopted by 118 countries and territories.

Board Matters Quarterly

The January 2018 issue of Board Matters Quarterly includes three articles from the EY Center for Board Matters. Topics include the board's role in corporate culture, next-generation ERM and an overview of the SEC chairman's comments on cybersecurity disclosures.

EY Trade Watch

This quarterly publication outlines key legislative and administrative developments for customs and trade around the world. Highlights of this issue include: (1) US President Trump imposes tariffs on steel and aluminum, (2) Canada files wide-ranging WTO dispute settlement complaint against US trade remedy law practices, (3) New requirements to support customs valuation of imported goods into Mexico, (4) China Customs adopts interim administrative procedure for advance rulings, (5) EU27 develops its approach to post-Brexit arrangements, and (6) UK government introduces new customs bill.

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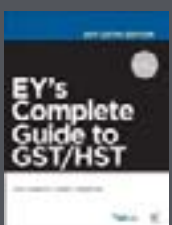
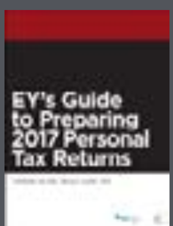


EY's Complete Guide to GST/HST, 2017 (25th) Edition

Editors: Dalton Albrecht, Jean-Hugues Chabot, Sania Ilahi, David Douglas Robertson

Canada's leading guide on GST/HST, including GST/HST commentary and legislation, as well as a GST-QST comparison. Written in plain language by a team of EY indirect tax professionals, the guide is consolidated to 15 July 2017 and updated to reflect the latest changes to legislation and CRA policy.

Check out the **video showcasing EY's GST tax leadership**.



EY's Guide to Preparing 2017 Personal Tax Returns

Editors: Lucie Champagne, Maureen De Lisser, Gael Melville, Yves Plante, Alan Roth

This is the line-by-line guide busy tax professionals rely on throughout the tax season. The guide includes a summary of what's new for the 2017 taxation year as well as tips, suggestions and reminders to consider when preparing 2017 personal tax returns. Available as an easy-to-use and searchable internet collection (includes access to four years of previous internet editions).

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