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The Exchange of Financial and Tax Information in Canada ... A Constantly Evolving Situation

For many years, Canada has been concerned with its tax base erosion. The situation has become increasingly critical as globalization has grown and the flow of goods and services has become more dispersed around the world. Economic and tax borders have become more and more tenuous and Canada, like many other countries, has struggled to respond to this new reality.

In order to reduce its tax base erosion and ensure that its tax laws are applied correctly, Canada, like many other countries, needed to gain access to the relevant information it required in order to continue to apply its tax laws.

Nine years ago, Canada only had one method at its disposal for obtaining some relevant information. This method was particularly limited.

The following is a description of five methods that are available to Canada in 2019 for the purposes of obtaining tax and financial information pertaining to investments or transactions made by Canadian taxpayers abroad.

1. **Bilateral Tax Conventions: Information Obtained Upon Request**

Historically, Canada has utilized the tax treaties it has entered into with a significant number of countries to gain

access to information on the foreign income of Canadian taxpayers or transactions they have made abroad. These are bilateral agreements that Canada has entered into with other states.

These agreements are based on the OECD Model Tax Convention of 1963. The primary purpose of these agreements is to prevent taxpayers from being subject to double taxation if they earn income abroad, by preventing the same income from being taxed in the foreign country in addition to being taxed in Canada, given the taxpayer's tax residence.

In addition, each of these agreements contains a provision to the effect that the signatory country may obtain tax information on one of its taxpayers or on one of the transactions in which said taxpayer is involved. These are the provisions pertaining to the exchange of information.

These bilateral agreements allow for the exchange of information at the request of one of the signatory countries, provided that it is reasonable to expect that the information so obtained would enable the requesting country to apply its tax laws.

To date, Canada has signed 96 bilateral tax conventions, 93 of which are currently in force.

However, Canada as well as other countries quickly realized that the information they could gain access to as a result of the provisions of the above-mentioned tax treaties was very limited due to the increased mobility of people, goods and businesses.

With the assistance of the OECD, additional information exchange mechanisms have been designed and implemented in numerous countries.

Accordingly, Canada now has access to four other methods for obtaining financial and tax information, in addition to the mechanisms provided under the bilateral tax treaties. In accordance with new bilateral or multilateral treaties, this information can be obtained upon request or from automatic information exchange mechanisms.

These additional means, which will be explained in detail below, are as follows:

- Multilateral agreements for the exchange of tax information upon request, spontaneous or automatic;
- Bilateral tax information exchange agreements with low tax or tax-free countries;
- Bilateral agreements for the automatic exchange of information relating to financial accounts; and
- Automatic exchange of tax returns country by country.

2. Multilateral Agreements for the Exchange of Tax Information upon Request, Spontaneous or Automatic

This convention was introduced by the OECD in 1988 and provides for several forms of cooperation between countries so that a signatory country can establish or collect taxes. This agreement generally applies to all taxes except customs duties.

This agreement contains mechanisms of exchange in any form, whether upon request (a country makes a request for information to another country), spontaneous (a country decides on its own to send tax information to other signatory countries), or automatic (countries will agree to exchange certain information automatically).

The signatory countries may also cooperate with each other to collect taxes from other countries. Canada is a signatory to this treaty, which came into force in Canada in 2014. 121 countries have signed this treaty to date.

3. Bilateral Tax Information Exchange Agreements with Low or Tax-Free Countries

These are mainly agreements signed by Canada with countries that do not have a tax treaty with Canada and have low tax rates or zero tax rates. Canada wishes to obtain tax or financial information on individuals or entities that may have Canadian tax liability and/or property or income in such countries. Requests for information are made by Canada and must provide to the other country a history of the concerned file and the reasons for its request.

To date, Canada has signed 25 of these agreements with countries that may qualify as tax havens. The best-known countries that have signed this treaty with Canada are the Bahamas, the Cayman Islands, the Turks and Caicos Islands, Bermuda, Barbados, Liechtenstein, etc. For example, if Canada has reason to believe that a Canadian taxpayer has engaged in transactions involving the Cayman Islands and holds bank accounts there, Canada may ask the government of the Cayman Islands to obtain financial information from financial institutions operating in the Cayman Islands.

4. Automatic Exchange of Information Relating to Financial Accounts

In 2013, the OECD began work to put in place a mechanism similar to the *Foreign Account Tax Compliance Act* (FATCA) of the United States for the automatic exchange of financial information between the signatory countries of the agreement.

As of 2014, more than 50 jurisdictions have signed an agreement to automatically exchange financial information. This is a multilateral agreement. The mechanism is as follows: a country's financial institutions collect financial information pertaining to their non-resident clients. This information is then submitted to the government of said country. Subsequently, such government transfers the financial information so collected to the government of the concerned clients' country of residence.

This information is sent to the government of the clients' country of residence no later than 9 months after the end of a given year.

To date, 98 states have signed this financial information exchange agreement. The first exchanges occurred between certain countries in 2017 and between others in 2018 or 2019. As a result of these agreements, bank secrecy now barely exists, at least as far as the financial information of individuals or entities circulating between governments is concerned.

In practice, all Canadian taxpayers who have accounts in most foreign countries will see their name and the nature and value of their foreign investments disclosed to the Canadian tax authorities.

5. Automatic Exchange of Tax Returns Country by Country

This measure is intended to prevent the tax base erosion between countries. This measure does not apply to all persons given that it targets corporations with total consolidated revenues of more than 1 billion Canadian dollars.

This measure applies to large corporations. The purpose of this measure is to ensure that income earned in one jurisdiction is taxed in that same jurisdiction, even if the income generated in the country where the corporation operates is lower than what it should have been as a result of inter-corporation transactions or transfers.

Corporations that qualify for this measure and who operate in one or several of the signatory countries will have to complete a particularly comprehensive questionnaire and provide financial and tax information on all their operations. This enables the signatory countries to ensure that there are no undue transfers of profits from one country to another so as to evade taxes that should have been paid in the country where the income was generated.

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This tax newsletter is the first in a series of three newsletters. As such, the upcoming newsletter will focus on the tax authorities' auditing powers in situations where documents are located abroad or where requests for information are made to third parties. This trilogy of newsletters will be completed by an example of a standard draft assessment for a Canadian taxpayer holding an unreported investment account abroad.

The content of this newsletter is intended to provide general commentary only and should not be relied upon as legal advice.

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