MEMORANDUM OF UNDERSTANDING BETWEEN THE COMPETENT AUTHORITIES OF CANADA AND THE UNITED STATES REGARDING THE MUTUAL AGREEMENT PROCEDURE

The Director General, International Tax Directorate, Canada Customs and Revenue Agency (CCRA), Competent Authority for Canada and the Director-International, Large and Medium Size Business (LMSB), Internal Revenue Service (IRS), Competent Authority for the United States through this Memorandum of Understanding ("MOU") agree to establish principles and guidelines to improve the performance and efficiency of the mutual agreement procedure ("MAP") process in accordance with the terms set forth in the *Canada-United States Income Tax Convention (1980)*, as amended from time to time (the "Convention").

<u>Purpose of the MAP</u>

The fundamental purpose of the MAP is to endeavour to resolve double taxation or taxation contrary to a convention. Upon making a MAP request, the taxpayer places responsibility for a principled and timely resolution of the issue in the hands of the respective Competent Authorities and the manner in which the resolution of double taxation is accomplished is at the discretion of the Competent Authorities. It is for this reason the two Competent Authorities have reached the following understandings:

I. <u>Emphasis on Reaching Agreement</u>. The Competent Authorities for Canada and the United States are committed to the principle that the resolution of double taxation or taxation contrary to the Convention should be possible in all cases. To improve the MAP process between our two countries, the Competent Authorities agree to adhere to the following principles and guidelines when seeking to reach a resolution in a particular case:

A. <u>Positions shall be Principled, Reasonable and Consistent</u>. The positions advanced by the Competent Authorities in each case should be well documented, have merit, and follow the principles of consistency and reciprocity. Consistency means the Competent Authorities will strive to ensure that similar cases are resolved in a similar manner. Reciprocity means the adjusting Competent Authority in a particular case should only advance a position that it would be prepared to accept if it were the relieving Competent Authority.

B. <u>Agreement on the Facts</u>. The Competent Authorities recognize the importance of reaching agreement on the facts in MAP cases. Disagreements on the facts as to the nature of a taxpayer's business operations can cause, or contribute to, difficulties in resolving a MAP case. Generally speaking, the Competent Authorities shall accept a transaction as structured by the taxpayer and only consider disregarding or restructuring a transaction in exceptional cases.

If the Competent Authorities are unable to obtain agreement on the underlying facts and circumstances of a particular MAP case after six months of negotiations, they shall agree to refer the case to a joint panel comprised of tax administration officials chosen by the Assistant Commissioner of Appeals for the CCRA and the Chief of Appeals for the IRS. An agreement reached as to the facts of the case will be binding on the respective MAP organizations. The details of this procedure will be set forth in a separate MOU between the Competent Authorities.

The Competent Authorities agree to consider conducting joint site visits with taxpayers in specific cases in an effort to reach agreement regarding the underlying facts and circumstances of a taxpayer's business; however, it is recognized that the use of joint site visits must be prudent and judicious, due to resource limitations in each of the respective tax administrations.

C. Means of Resolving Cases. Despite the best efforts of Competent Authority officers, it is recognized that substantive differences on issues may complicate the ability to reach a resolution on a specific case even when there is agreement on the underlying facts and circumstances of the case.

In these situations, Competent Authority officers shall look for appropriate opportunities to compromise. Compromise is often required when diverging views otherwise make resolution difficult to achieve.

If resolution is still not possible, the appropriate first level managers in the Competent Authority organizations will jointly undertake a detailed review of the case to ensure that all appropriate action has been taken to facilitate a resolution. If a MAP request has not been resolved within two years from its date of acceptance, the Director General, International Tax Directorate, CCRA and the Director-International, LMSB, IRS agree to meet, or, if more appropriate, agree to have their subordinates meet, in order to resolve the case.

II. Procedural Issues. Procedural issues may delay or impede the resolution of MAP cases. These issues could result from administrative policies, practices and procedures of the respective Competent Authority organizations.

A. Removal of Barriers. It is hereby agreed that administrative policies, procedures and practices that impede or delay the process of resolving a MAP case will be identified and removed to the extent possible under the delegated powers of the Competent Authorities in their respective tax administrations.

B. <u>Notification</u>. The Competent Authorities also agree to interpret "notification" broadly under the Convention so as to reflect the intention to be as inclusive as possible when considering requests for MAP assistance. A separate MOU to be executed by the Competent Authorities will address a number of issues surrounding notification.

III. <u>Substantive Issues in MAP Cases</u>. The Competent Authorities will follow the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* to resolve substantive issues in cases involving transactions between related parties. Notwithstanding, the Competent Authorities have identified a number of issues that have resulted, or could result, in a failure to resolve double taxation or taxation contrary to the Convention. These issues include, but are not limited to, the determination of:

- an arm's length compensation for consignment manufacturing operations;
- whether a business is integrated to the point where a profit split method is appropriate and, if so, the relative value of contributions made by related parties toward the generation of profit;
- the presence of non-routine intangible assets and the determination of an arm's length value;
- whether a permanent establishment (PE) exists and the amount of profit to be attributed to the PE;
- whether a transaction is properly characterized as a service versus a license of intangibles;
- the amount of compensation, if any, upon either the closure or relocation of a business and the allocation of associated closing costs; and
- appropriate relief where source and residence country's laws are in conflict.

The Competent Authorities express their commitment to reach an agreement establishing guidelines to be applied with respect to resolving cases involving the issues identified above as well as other issues that are identified and agreed to by the Competent Authorities. The Director General, International Tax Directorate, CCRA and the Director-International, LMSB, IRS will designate one or more representatives from their respective organizations to meet for the purpose of establishing such guidelines for the above issues as well as other issues that are identified and agreed to. Moreover, the Director General, International Tax Directorate, CCRA and the Director-International, LMSB, IRS agree to designate one or more representatives from their respective competent authority organizations to meet at such time as new issues emerge that impede the resolution of MAP cases. The Director General, International Tax Directorate, CCRA and the Director-International, LMSB, IRS recognize that they may be required to look beyond their own Competent Authority organizations to find a designate elsewhere within their respective tax administration with the appropriate level of expertise to assist in developing guidelines.

Conclusion

Through the execution of this MOU, our respective Competent Authority organizations will initiate discussions as soon as possible to: (1) create a MOU to establish a binding procedure to determine the underlying facts and circumstances of a specific case; (2) create a set of guidelines to be used in resolving cases involving the above substantive issues that complicate case resolution; (3) identify and remove procedural obstacles that impede or delay the process of resolving double taxation cases; and (4) create a MOU to address a number of issues surrounding notification.

Other Provisions

The Competent Authorities for Canada and the United States agree to publish this MOU to demonstrate our mutual commitment to improving the MAP process.

This is a MOU between the Competent Authorities of Canada and the United States addressing procedural matters under the Convention. This MOU is not to be interpreted as creating any cause of action, rights or benefits in favor of third parties or taxpayers.

This MOU may be modified at any time by agreement between the Competent Authorities. The Competent Authorities agree to implement this MOU as soon as possible after signing this agreement. Either Competent Authority may terminate the MOU at any time by giving written notice to the other competent authority.

Competent Authority for Canada	Competent Authority for the United States
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Frederick R. O’Riordan Director General International Tax Directorate Canada Customs and Revenue Agency	Robert H. Green Director-International Large and Medium Size Business Internal Revenue Service
Date:___________________________	Date:_________________________