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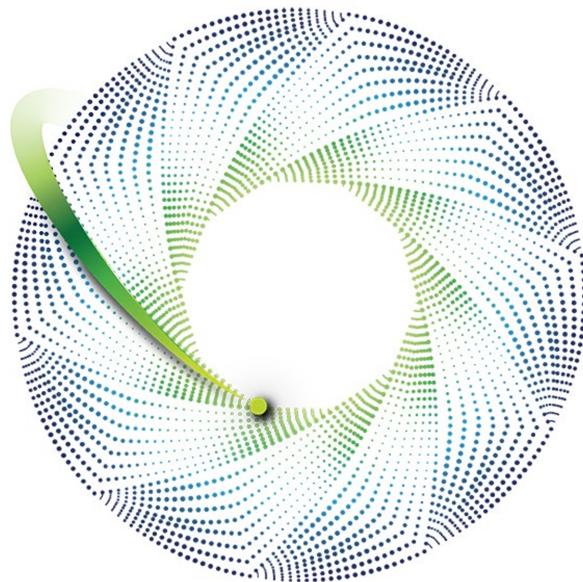

Canadian Tax & Legal Alert

Enhanced mandatory disclosure rules: new reporting obligations for taxpayers and their advisors

June 19, 2023

Background

Canada's Bill C-47, *Budget Implementation Act, 2023 No. 1*, received third reading in the House of Commons on June 8, 2023 and is expected to receive Royal Assent shortly, following consideration by the Senate. Among other things, the Bill implements certain measures from Budget 2023, including significant changes to mandatory disclosure rules in the Income Tax Act (the "Act"). These proposals, first announced in Budget 2021, impose significant changes to the disclosure of certain tax transactions for both taxpayers and their advisors. The changes would be effective for reportable or notifiable transactions entered into after Royal Assent, which is expected prior to Parliament's last sitting day, currently scheduled for June 30, 2023.

Overview

Budget 2021 proposed changes to the mandatory disclosure rules in the Act, to align Canada with Action 12[1] of the Base Erosion and Profits Shifting (BEPS) project of the Organisation for Economic Co-operation and Development (OECD). Note that the proposals resemble the expanded disclosure obligations already implemented by the Province of Quebec.

Importantly, the reporting obligations for both reportable and notifiable transactions would apply to any person for whom a tax benefit results, including if a transaction is part of a series of transactions. The inclusion of the concept of a "series of transactions" will require taxpayers to more broadly examine a series of transactions to ensure appropriate reporting is undertaken.[2]

Information would not be required to be disclosed if it is reasonable to believe that the information would be subject to solicitor-client privilege.

Contacts:

Rob Jeffery
National Tax Policy Leader
Tel.: 902-721-5593

Mike Smith
National Tax Office Leader
Tel.: 403-267-0661

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Reportable transactions

Bill C-47 proposes changes to the existing reportable transaction rules provided under section 237.3 of the Act. The existing rules require the disclosure of a transaction when at least two of three generic hallmarks are met (discussed below) for an avoidance transaction, as defined in subsection 245(3) of the Act. **The proposed rules reduce the threshold to one of the generic hallmarks, with some modifications, and amend the definition of an avoidance transaction.** Furthermore, **reporting would be required by the taxpayer and any advisors or promoters**, whereas the existing rules allow for a single filing per reportable transaction on behalf of all parties.

A reportable transaction must first be an avoidance transaction before considering whether hallmarks are present. Bill C-47 amends the definition of an avoidance transaction, for these purposes only, to mean a transaction if it may reasonably be considered that one of the main purposes of the transaction is to obtain a tax benefit. This is a lower threshold than the existing definition, which uses a primary purpose test. Interestingly, the modified definition aligns with the proposals in Budget 2023 to modify the definition of an "avoidance transaction" for the purposes of the General Anti-Avoidance Rule (GAAR).

Contingent fees hallmark

A contingent fee hallmark may exist where the fee paid to an advisor or promoter to any extent is based on the amount of a tax benefit that could result, is contingent on achieving the tax benefit, or is attributable to the number persons who either participate in the avoidance transaction or who have been provided access to advice or an opinion by the advisor or promoter regarding the tax consequences from the avoidance transaction.

Scientific Research and Experimental Development **(SR&ED) claims would be excluded** through legislation, if they are required to be disclosed in *Form T661 – SR&ED Expenditures Claim*. Furthermore, the explanatory notes[3] exempt situations where fees are agreed to at the time of billing and based on a variety of criteria other than the value of the tax benefit resulting from the transaction. **Contingent litigation fees** are also not expected to be reportable, provided the fee arrangement was implemented after the completion of the transaction giving rise to an assessment that is subject to the appeal.

[1] "BEPS Action 12 provides recommendations for the design of rules to require taxpayers and advisors to disclose aggressive tax planning arrangements. These recommendations seek a balance between the need for early information on aggressive tax planning schemes with a requirement that disclosure is appropriately targeted, enforceable and avoids placing undue compliance burden on taxpayers." (https://www.oecd.org/tax/beps/beps-actions/action12/)
[2] For the purposes of this alert, the use of the term "transactions" includes reference to a "series of transactions" for ease of readability.
[3] Canada, Department of Finance, *Explanatory Notes Relating to the Income Tax Act and Other Legislation* (Ottawa: Department of Finance, April 2023) (the "explanatory notes").

Contractual protection hallmark

A contractual protection hallmark exists where any person provides any form of insurance (including indemnities or guarantees) that may protect a person against a failure of a transaction to achieve any tax benefit, or to reimburse any expenses, tax, interest or penalties that may be incurred by a person in the course of a dispute.

Bill C-47 provides **two exclusions from this hallmark**: professional liability insurance, and certain indemnities in an arm's length sale or transfer of all or part of a business. The arm's length business transfer exception would apply where it is intended to ensure the purchase price of a transaction is reflective of assumed liabilities. The exception is intended to address standard representations and warranties (including traditional representations and warranties insurance policies), but would not extend to specific identified tax risks, such as through the use of tax liability insurance.

Concerns had previously been raised by many in the tax community regarding the breadth of the interpretation of this hallmark, particularly in mergers and acquisitions transactions. The explanatory notes make it clear that **arm's length commercial transactions** would not be expected to be reported, absent specific identified tax risks beyond standard representations and warranties. Reporting may also be applicable to non-arm's length transactions, should indemnifications be present.

Confidentiality hallmark

A confidentiality hallmark exists where there is a restriction on the disclosure by any person to the Canada Revenue Agency (CRA) of the details or structure of a transaction or a series of transactions under which a tax benefit results. Disclaiming or restricting an advisor's liability is not considered confidential protection if there is no restriction on disclosure of the details.

There are no amendments to the confidentiality hallmark under Bill C-47.

Notifiable transactions

Bill C-47 introduces a reporting requirement for a new category of transactions: "notifiable transactions."[4] A notifiable transaction is "a transaction that is the same, or substantially similar to, as a transaction designated" by the CRA with the concurrence of the Minister of Finance. A **substantially similar transaction** exists if the types of tax consequences obtained are the same or substantially similar, which term is intended to be interpreted broadly in favour of disclosure.

The disclosure obligations would apply to taxpayers and all advisors. Advisors are broadly defined as anyone who provides any assistance or advice with respect to creating, developing, planning, organizing or implementing the transaction. Reporting would not apply if due diligence can be demonstrated and a person did not know, or was not reasonably expected to know, that the transaction was a notifiable transaction. The explanatory notes describe that a taxpayer could generally meet their due diligence obligations by asking their advisors about potential reporting obligations.

Sample notifiable transactions were announced by the Department of Finance on February 4, 2022, as part of a backgrounder[5] during the consultation on an earlier draft of the legislation. As of the date of this document, there are no designations of notifiable transactions, although such designations would be expected following Royal Assent. Notifiable transactions may be designated by the CRA, with the concurrence of the Department of Finance, by posting on the CRA's website.

[4] Section 237.4 of the Act.

[5] Canada, Department of Finance, *Income Tax Mandatory Disclosure Rules Consultation: Sample Notifiable Transactions* (Ottawa: Department of Finance, February 2022).

The sample notifiable transactions previously announced consisted of the following:

- Manipulating Canadian controlled private corporation (CCPC) status to avoid anti-deferral rules applicable to investment income
- Straddle loss creation transactions using a partnership
- Avoidance of deemed disposal of trust property
- Manipulation of bankrupt status to reduce a forgiven amount in respect of a commercial obligation
- Reliance on purpose tests in section 256.1 to avoid a deemed acquisition of control
- Back-to-back arrangements [in relation to thin-capitalization rules or reduction of withholding tax]

As notifiable transactions are designated, taxpayers should consult the relevant notice to ensure that the scope of the transaction is understood, particularly given the need to assess whether a transaction is "substantially similar."

Uncertain tax treatments

Bill C-47 also introduces a reporting requirement for uncertain tax treatment[6] whereby certain Canadian corporations would be required to **disclose uncertain tax treatments that are reflected in audited financial statements for taxation years commencing after 2022**. The disclosure obligations would apply to a corporation with audited financial statements under International Financial Reporting Standards (IFRS) or comparable country specific generally accepted accounting principles (GAAP) used by public companies (e.g., US GAAP), or that is part of a consolidated filing under the same standards. Corporations must also have a carrying amount of assets greater than $50 million.

Any uncertainty reflected in the audited financial statements pertaining to taxes should be reported on or before the corporation's normal filing deadline.

Consequences of non-compliance

Under Bill C-47, the proposed timelines and consequences of non-compliance can be summarized as follows:

- **Time for filing the return** – Reportable and notifiable transactions must be disclosed within 90 days from the earlier of when the person becomes contractually obligated to enter into the transaction or when the transaction is entered into. This is an acceleration from the existing deadlines, which requires filings by June 30 following the calendar year of the transaction.
- The existing rules provide for joint and several liability for those required to file, given the nature of a single filing per transaction. With individual reporting obligations now established, the **joint and several liability is repealed** for transactions entered into after Royal Assent.
- Financial penalties do not apply to the reporting of uncertain tax treatments for taxation years that begin before the date on which Royal Assent is received.
- **Taxpayers are subject to a financial penalty** for late filing of up to $2,000 per week, up to a maximum of the greater of $100,000 or 25% of the tax benefit. Reduced penalties are applicable where the carrying value of a corporation's assets is less than $50 million. For the late reporting of uncertain tax treatments, the penalty is $2,000 per week, up to a maximum of $100,000.
- **Advisors are subject to a financial penalty** for late filing equal to $1,000 per day (up to a maximum of $100,000), plus $10,000 and the amount of fees charged. Therefore, in the event of a late filing by an advisor, the minimum penalty would be the entirety of professional fees plus $11,000.

[6] Section 237.5 of the Act.

- In addition to financial penalties, the **normal reassessment period** (statute barring) of a taxation year will not commence until the required filings are completed, to the extent the year contained a reportable or notifiable transaction.
- Furthermore, if timely filings are not made for a reportable transaction, the **GAAR is deemed to apply**[7] regardless of whether the misuse or abuse test in subsection 245(4) is met. The traditional GAAR determination is reinstated when filings are made by the taxpayer and advisors and any resulting penalties are paid.

How can Deloitte help you?

Deloitte's professionals can help you understand how these measures may impact your business. In particular, businesses will need systems and processes to identify any transaction which has a generic hallmark and is therefore a reportable transaction or may be a notifiable transaction.

If you have questions on any of the above, please reach out to your Deloitte advisor or any of the individuals noted on this alert.

[7] A transaction would also need to be an "avoidance transaction" as defined in section 245 for the GAAR to apply, as there are currently separate definitions for an "avoidance transaction" for the purposes of reporting a reportable transaction and for the purposes of the GAAR. Budget 2023 proposed modifications to the GAAR which would, among other things, align the definition of an "avoidance transaction" to the lower standard now found for the purposes of reportable transactions.

Deloitte LLP
Bay Adelaide Centre, East Tower
8 Adelaide Street West, Suite 200
Toronto ON M5H 0A9
Canada

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