Grant Thornton

TAX ALERT

Proposed mandatory disclosure rules

UPDATED: NOVEMBER 7, 2022

As announced in the 2021 federal budget plan (Budget 2021), the government proposes to expand the mandatory disclosure rules contained in the Income Tax Act (the Act) to require taxpayers, advisors and promoters (and certain other parties) to disclose relevant information on aggressive tax planning or transactions to the Canada Revenue Agency (CRA).

On February 4, 2022, the Department of Finance (Finance) released draft legislation for public comment, which include the following changes to the mandatory disclosure rules:

1. An expansion of the Act's reportable transaction rules, along with a significantly reduced reporting deadline;
2. A new requirement to report notifiable transactions;
3. A new requirement for certain corporations to report uncertain tax treatments;
4. An extension of the normal reassessment period in non-compliance situations; and
5. New related penalties (some of which accrue daily or weekly).

Overall, if the proposals are enacted in their current form, the compliance burden for taxpayers, advisors and promoters is anticipated to be significantly increased.

On August 9, 2022, Finance updated the draft legislation in response to feedback received during the consultation period. One major change is that the application date of the mandatory disclosure rules has been pushed back to 2023 from 2022.

On November 3, 2022, Finance announced that in order to better assess further consultation feedback that it received, it intends to delay the date of application of the proposed reporting requirements for both reportable transactions and notifiable transactions to the date on which the new rules receive Royal Assent (previously, was to be applicable to transactions entered into after 2022). The application date for uncertain tax treatments was left unchanged.

Status of the proposals

BUDGET 2021 ANNOUNCED PROPOSED CHANGES

FIRST CONSULTATION PERIOD ENDED ON APR. 5, 2022

SECOND CONSULTATION PERIOD ENDED ON SEP. 30, 2022

DRAFT LEGISLATION RELEASED ON FEB. 4, 2022

DRAFT LEGISLATION UPDATED ON AUG. 9, 2022

DELAY OF CERTAIN REPORTING REQUIREMENTS ANNOUNCED ON NOV 3, 2022

Proposed application timeline

As outlined below, if enacted, the proposed mandatory disclosure rules would apply as follows:

Type of transaction	Reporting requirement proposed application	Penalty provision proposed application
Reportable transactions **and** Notifiable transactions	Applicable to transactions entered into on or after the date on which the legislation receives Royal Assent	Will not apply to transactions entered into before the legislation receives Royal Assent
Uncertain tax treatment	Applicable to taxation years beginning after 2022	Will not apply to taxation years that begin before the date on which the legislation receives Royal Assent

Reportable transactions

Under the current legislation[1], the taxpayer, anyone who enters into the plan on behalf of the taxpayer, and any advisors or promoters [2] of the tax plan must file the RC312 - Reportable Transaction Information Return to disclose relevant information on a "reportable transaction" to the CRA. A transaction[3] is reportable if it is an "avoidance transaction" as defined under the General Anti-Avoidance Rule (GAAR), and has at least two of the following three hallmarks:

1 **Fees:** A promoter or tax advisor in respect of the transaction is entitled to a direct or indirect fee (absolutely or contingently) that is:
   - based on the tax benefit;
   - contingent upon obtaining a tax benefit; or
   - attributable to the number of taxpayers that participate in or have been provided access to the advice given on the tax consequences of the transaction.

2 **Confidential Protection:** A promoter or tax advisor requires "confidential protection" with respect to an avoidance transaction. The prohibition on disclosure specifically involves the tax treatment of the avoidance transaction (e.g., where the client is prohibited to disclose the details or structure of the transaction involving a tax treatment to any person or to the Minister of National Revenue).

3 **Contractual Protection:** The taxpayer, promotor or advisor (or certain other specified or non-arm's length persons), receives "contractual protection" in respect of the transaction, including any form of insurance (other than standard professional liability insurance), or any form of undertaking provided by a promoter that aids a person in a dispute about the tax benefit. Contractual protection in a normal commercial or investment context would not give rise to a hallmark if the protection does not extend to the tax treatment in respect of an avoidance transaction.

The proposed legislation significantly expands the scope of a "reportable transaction" and the compliance burden for the relevant parties as each party would need to report separately. Furthermore, the filing deadline is reduced to only 45 days, and the new late-filing penalties can be significant.

1 Section 237.3 of the Act.
2 A promotor or advisor for the purposes of this article generally also includes any non-arm's length party to the promotor or advisor that is entitled to receive a fee related to the transaction.
3 A "transaction" for the purposes of this article also includes the series of transactions in which a particular transaction is included.

The changes are summarized in Table 1 as follows:

Table 1: High-level comparison of current and proposed legislation

	Current legislation	Proposed legislation
Purpose test	Transaction is an avoidance transaction if the primary purpose of entering into the transaction is to obtain a tax benefit (i.e., definition under GAAR)	Transaction is an avoidance transaction if it can reasonably be concluded that one of the main purposes of entering into the transaction is to obtain a tax benefit
Three hallmarks	Must meet at least two of the three hallmarks	Only needs to meet at least one of the three hallmarks
Reporting deadline	On or before June 30th of the calendar year following the year in which the transaction became a reportable transaction	Within 45 days of the earlier of when the taxpayer (or anyone acting on behalf of the taxpayer) enters the transaction or become contractually obligated to enter the transaction
Reporting obligation	One person can file an information return in respect of the reportable transaction on behalf of all relevant parties.	All relevant parties (e.g., any taxpayer receiving a tax benefit[4] from the plan, anyone who has entered into the transaction on behalf of a taxpayer benefitting from the plan, and each advisor[5] or promotor) must file an information return in respect of the same reportable transaction. The reportable transaction reporting obligation would not apply to persons that provide only clerical or secretarial services with respect to the planning.
Penalties for non-compliance	The amount of the penalty for each relevant party is generally the total of all the fees for the transaction that the promoter or advisor is entitled to receive	Significant penalties for taxpayers, promoters, advisors and certain other parties, which can be as high as $100,000 or more (see Table 2 for details)

4 A taxpayer expecting to receive a tax benefit under the plan based on their tax treatment of the reportable transaction must also report, even if their filing position is successfully challenged.
5 A lawyer who is an advisor may be excluded from the reporting requirements where there is solicitor-client privilege as defined in relevant case law.

Notifiable transactions

In addition to the "reportable transactions" disclosure requirement, the government proposes to introduce a similar requirement to report "notifiable transactions", which include types of transactions the CRA has either found to be abusive or to be of interest (and for which more information is needed to determine whether the transaction is abusive).

If enacted, the Minister of National Revenue would have the authority to designate, with the concurrence of the Minister of Finance, a transaction as a "notifiable transaction". The Department of Finance has provided the following six sample types of notifiable transactions for the purpose of these rules:

1. A corporation taking steps to avoid being a Canadian-controlled private corporation to circumvent the anti-deferral rules for investment income.
2. Using partnerships in derivative transactions to generate artificial losses and avoid the application of the "straddle transaction" stop-loss rules.
3. Avoiding or deferring the deemed disposition rules for trusts by indirectly transferring the trust property to another trust.
4. Temporarily obtaining bankruptcy status to reduce a forgiven amount in respect of a commercial obligation.
5. Avoiding a deemed acquisition of control, which is subject to the tax attribute trading restrictions, by relying on one of the purpose tests in subsection 256.1(2), (4) or (6) of the Act.
6. Using "back-to-back" arrangements to circumvent the thin capitalization rules or Part XIII withholding tax.

The transaction would only need to be substantially similar to one of the above scenarios, with "substantially" intended to be interpreted broadly and in favour of disclosure.

The proposed provisions for the filing deadline, reporting obligation and penalties in respect of a "notifiable transaction" mirror those provisions for a "reportable transaction" described in Table 1 above.

While Québec's rules are beyond the scope of this article, it is notable that the Québec mandatory disclosure rules already contain a requirement to report certain "determined transactions" to Revenu Québec, similar to the "notifiable transactions" that must be reported to CRA under the federal proposals. Quebec's list of determined transactions currently includes avoiding the deemed disposition rules for a trust as well as transactions involving tax attribution trading (similar to the federal proposals), along with transactions involving payment to a non-treaty country and transactions used to multiply the capital gains deduction.

Uncertain tax treatments

The proposals also include a new requirement to disclose particular uncertain tax treatments. An uncertain tax treatment is generally a tax position taken by the taxpayer for which there is uncertainty (less than 50% probability) over whether the position will be accepted as being in accordance with the tax law. The proposed rules would generally apply to a corporation that meets the following conditions for a taxation year:

- The corporation is required to file a Canadian income tax return for the year;
- The carrying value of the corporation's assets at the end of the year is $50 million or more;
- The corporation, or a consolidated group of which the corporation is a member, has audited financial statements in accordance with International Financial Reporting Standards (IFRS) or country-specific Generally Accepted Accounting Principles (GAAP) for domestic public companies (e.g., US GAAP); and
- One or more uncertain tax treatments are reflected in those audited financial statements.

Under the proposals, if a corporation meets the criteria for a tax year, the uncertain tax treatment(s) must be disclosed in an information return to be filed with the CRA no later than the date the corporate income tax return is due (e.g., six months after the taxation year-end). The proposed penalties to the taxpayer for failure to report an uncertain tax treatment when required are significant (up to $100,000 – see Table 2 for details).

Reassessment period

Where a taxpayer has a mandatory disclosure reporting requirement (e.g., reportable transactions, notifiable transactions, uncertain tax treatments), under the proposals, the normal reassessment period[6] would not begin in respect of the transaction until the taxpayer is compliant. In other words, a reassessment will not become statue-barred if these reporting requirements are not met.

6 Where an information return required under the mandatory disclosure rules is filed late, the reassessment period would be four years from the date it is filed for mutual fund trusts or corporations that are not Canadian-controlled private corporations, and three years for other taxpayers.

Penalties

The proposed penalties for non-compliance with the new mandatory disclosure rules are summarized in Table 2 as follows:

Table 2: Proposed penalties for failure to file

	Taxpayer		Each Promoter or Advisor
	Weekly penalty	Maximum penalty	
Reportable or notifiable transactions (Corporations with more than $50 million assets)	$2,000 per week	Greater of: a. $100,000 or b. 25% of tax benefit	Total of: • 100% of the fees charged for the transaction; • $10,000; and • $1,000 per day to a maximum of $100,000
Reportable or notifiable transactions (All other taxpayers)	$500 per week	Greater of: a. $25,000 or b. 25% of tax benefit	
Uncertain tax treatment	$2,000 per week for each position	$100,000 for each position	Not Applicable

Penalties will not apply to transactions that occur before the legislation receives Royal Assent.

Additional information

As of the date of this article, the proposed mandatory disclosure rules have not received Royal Assent, and the draft legislation may change based on the feedback Finance receives during the additional consultation period. The proposed rules are complex and the penalties for non-compliance are significant. Accordingly, please reach out to your Grant Thornton advisor if you require assistance navigating these proposals.