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Tax Alert – Canada

New mandatory disclosure rules are now in effect

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 22 June 2023, the new rules to enhance Canada's mandatory disclosure requirements included in Bill C-47, *Budget Implementation Act, 2023, No. 1*, became enacted.[1] The new rules, which include an expansion of the existing reportable transaction rules and new reporting requirements for notifiable transactions and reportable uncertain tax treatments, are intended to provide the Canada Revenue Agency (CRA) with earlier access to relevant information for certain transactions and tax planning arrangements.

Also, on 5 July 2023, the CRA published guidance on the new rules on two new webpages, which provide an overview of the mandatory disclosure rules, as well as more detailed guidance on the mandatory disclosure rules.

The new mandatory disclosure rules for reportable transactions and notifiable transactions, including the imposition of penalties, apply for transactions entered into after 22 June 2023. In the case of reportable uncertain tax treatments, the new mandatory disclosure rules apply for taxation years beginning after 2022. However, in the latter case, penalties will not apply to taxation years that begin before 22 June 2023.

In this Tax Alert, we briefly summarize the new mandatory disclosure measures included in Bill C-47 and provide an overview of the guidance released to date by the CRA with respect to application of the new rules.

[1] For more information on Bill C-47, see EY Tax Alert 2023 Issue No. 27, *2023 budget implementation bill no. 1 is enacted*.

Building a better working world

Background

The 2021 federal budget outlined broad proposals to enable the CRA to have better visibility of transactions or tax reduction planning that it would consider aggressive in nature. These proposals are based on the principles set out in the Organisation for Economic Co-operation and Development project to identify base erosion and profit shifting, Action 12: Final Report.

The proposals focused on:

1. Strengthening of the existing reportable transaction rules in section 237.3 of the *Income Tax Act* (Canada) (the Act);

2. New reporting requirements for certain notifiable transactions that are designated by the Minister of National Revenue;

3. New rules to require larger corporations to report to the CRA all "reportable uncertain tax treatments" that were required to be disclosed in their audited financial statements; and

4. The indefinite extension of the reassessment periods and penalties for non-compliance, including the expansion or introduction of reporting requirements and penalties for professional tax advisors and promoters in certain circumstances.

Following the release of draft legislative proposals and a consultation period that ended in September 2021, the Department of Finance released amended draft legislative proposals on 4 February 2022.

To take into account further feedback provided by stakeholders, the Department of Finance released for public comment revised draft legislative proposals on 9 August 2022 and indicated that the application date for the measures would be deferred by one year.

On 20 April 2023, legislative proposals, as modified since their last release on 9 August 2022, were included in Bill C-47.

Reportable transactions

Bill C-47 amends the existing rules for reportable transactions to make the rules more effective and consistent with international leading practices.

First, the definition of "avoidance transaction" for purposes of these rules is amended so that a transaction is considered an avoidance transaction if it can reasonably be concluded that one of the main purposes of entering into the transaction (or series that includes the transaction) was to obtain a tax benefit. Under the previous rules, the term "avoidance transaction" had the same meaning as defined under the general anti-avoidance rule (GAAR)

in section 245 of the Act. As such, the amendment results in a lower threshold for there to be an avoidance transaction under the reportable transaction rules than under the current GAAR regime, which uses a primary purpose test.[2]

Second, under the new rules, only one of the three generic hallmarks for reportable transactions — contingent fee arrangement, confidential protection and contractual protection — needs to be met for a transaction to be reportable, instead of two conditions under the previous rules.

Third, the deadlines for filing an information return disclosing the reportable transaction to the CRA are accelerated and more complex. More specifically, Bill C-47 requires a taxpayer who enters into a reportable transaction, or another person who enters into a reportable transaction in order to obtain a tax benefit for the taxpayer, to report the transaction within 90 days of the earlier of:

- The day the taxpayer or other person becomes contractually obligated to enter into the transaction; and
- The day the taxpayer or other person enters into the transaction.

Reporting within the same time limits is also required by a promoter or advisor of an arrangement (or other person who does not deal at arm's length with a promoter or advisor and who receives a fee with respect to the arrangement) that would be a reportable transaction if it were implemented. An exception to this rule is provided for advisors to the extent of solicitor-client privilege.

Lastly, Bill C-47 includes various additional modifications to the amended reportable transaction rules since their last release on 9 August 2022. Most notably, clarifying amendments have been provided on the contractual protection hallmark to exclude, among other items, certain commercially standard value-protection provisions (e.g., indemnities for standard representations and warranties), and the definition of "reportable transaction" is modified to specifically exclude from the contingent fee arrangement hallmark fees received for the preparation of scientific research and experimental development (SR&ED) claims. These hallmarks are discussed in greater detail in the following section.

[2] As announced in the 2023 federal budget, the government intends to make various changes to the GAAR regime, including lowering the avoidance transaction standard. To learn more, see EY Tax Alert 2023 Issue No. 20, *Federal budget 2023-24*.

Guidance from the CRA

The following information outlined on the CRA's guidance webpage is of particular interest in applying the new rules with respect to reportable transactions:

- The CRA confirms that there is no legislative reporting obligation for a transaction or series of transactions where none of the three generic hallmarks are present even though it can reasonably be concluded that one of the main purposes of entering into the transaction or series of transactions is to obtain a tax benefit. Examples of where this may be the case include transactions related to estate freezes, debt restructuring, loss consolidation, shareholder loan repayments, claiming of the capital gain exemption and purification transactions, divisive reorganizations and foreign exchange swaps.
- The CRA outlines examples that, in and of themselves, would generally not satisfy the contingent fee arrangement hallmark. Among the examples provided are:
  - Fees for the claiming of SR&ED tax credits;
  - Fees for the preparation of annual income tax returns resulting in the taxpayer obtaining a refund of tax or entitlement to personal tax credits, such as the disability tax credit or refundable tax credits;
  - Fees solely based on the number of filings of income tax elections in respect of a transaction or series of transactions, such as the filing of section 85 elections billable on a per-transferor basis;
  - Fees attributable to the number of taxpayers participating in a transaction, provided the fees are only contingent on the number of returns or elections prepared and not the attainment of the tax benefit (e.g., a section 85.1 share for share exchange, and a wind-up or amalgamation under subsections 88(1) and 87(1), respectively);
  - Fees based solely on the value of services provided in respect of a transaction or series, determined without reference to the tax results of the transaction or series (e.g., value billing by professionals); and
  - Contingent fees relating to an appeal of a tax assessment by a lawyer in respect of a completed transaction or series (a reporting obligation would, however, be expected to arise for a litigator in relation to a contingent litigation fee arrangement that is put in place prior to the completion of a transaction or series).
- The CRA outlines examples that, in and of themselves, would not generally satisfy the contractual protection hallmark. Among the examples provided are:
  - Normal professional liability insurance of a tax practitioner;
  - Standard representations, warranties and guarantees between a vendor and purchaser that are generally obtained in the ordinary commercial context of mergers and acquisitions to protect a purchaser from pre-sale liabilities (including tax liabilities);

- Other contractual protection in the form of insurance that is integral to an agreement between arm's length persons for the sale of a business to ensure the purchase price takes into account any pre-sale liabilities of the business (and not to obtain a tax benefit), such as indemnities related to existing pre-closing tax issues or the amount of existing tax attributes;

- Tax insurance acquired in relation to the purchase of taxable Canadian property from a nonresident of Canada, who could be liable for 25% (or in some cases 50%) of the purchase price in the absence of a certificate of compliance issued by the CRA under subsection 116(2) or subsection 116(4) in respect of the disposition;

- Standard price adjustment clauses, such as those contemplated in Income Tax Folio S4-F3-C1, *Price Adjustment Clauses*; and

- Advance income tax rulings.

- In the context of a transaction (or series) for which a favourable advance income tax ruling has been issued and a reporting obligation exists under the reportable transaction rules, a copy of the ruling can be attached to the upcoming revised Form RC312, *Reportable Transaction and Notifiable Transaction Information Return*, to satisfy the detailed reporting (aside from providing the identification of the reporting person on the form).

- If a partnership or employer discloses a reportable transaction as required, its partners or employees would generally not also need to make a disclosure.

- As noted above, the new rules apply for transactions entered into after 22 June 2023; however, the CRA also notes that the rules apply to transactions that "straddle" this date. For example, if a person contracted to enter into a reportable transaction on 1 June 2023 but did not actually enter into the transaction until 30 June, the reporting obligations under the new rules will apply and the 90-day reporting period will begin on 30 June 2023. Also, where a person enters into a series of transaction that straddles 22 June 2023, the reporting requirement will be triggered with the first reportable transaction entered into after 22 June 2023.

Notifiable transactions

Notifiable transactions are a new category of transactions introduced in new section 237.4 of the Act. These rules are intended to provide the CRA with pertinent information relating to tax avoidance transactions and other transactions of interest on a timely basis.

Bill C-47 provides the Minister of National Revenue (with the concurrence of the Minister of Finance) with the authority to designate "notifiable transactions," which will include types of transactions that the CRA has found to be abusive, as well as transactions of interest (i.e., where more information is required to determine if a transaction is abusive).

Broadly speaking, taxpayers who enter into a notifiable transaction (or other persons who enter into notifiable transactions for the benefit of a taxpayer), as well as promoters or advisors of an arrangement (or other non-arm's length persons who receive a fee with respect to the arrangement) that would be a notifiable transaction if implemented, will be required to report the transaction (or series of transactions) within the same time limits listed above for reportable transactions. An exception is provided for advisors to the extent of solicitor-client privilege.

A transaction will be a notifiable transaction if it is the same as, or substantially similar to, a transaction designated by the Minister, or a transaction in a series of transactions that is the same as, or substantially similar to, a designated series of transactions. For these purposes, any transaction or series of transactions that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or a similar tax strategy will be considered to be substantially similar. Furthermore, the legislation specifies that the phrase "substantially similar" is to be interpreted broadly in favour of disclosure.

The CRA's upcoming list of designated transactions or designated series of transactions will be made available through its website. In the meantime, see the samples of notifiable transactions that were provided for consultation on 4 February 2022, in a Department of Finance backgrounder.

Bill C-47 also includes reporting exceptions and clarifications, including a "reasonable expectation to know" rule, which generally provides that only advisors/promoters who know, or are reasonably expected to know, of their reporting obligations are required to file the required information with respect to a notifiable transaction. A due diligence defence for taxpayers is also available — i.e., there is an exemption from disclosure if the person has exercised the degree of care, diligence and skill in determining whether the transaction is a notifiable transaction that a reasonably prudent person would have exercised in comparable circumstances.

Employees and partners are deemed to have met their reporting requirement with respect to notifiable transactions when the employer or partnership has filed the required information return.

Guidance from the CRA

The CRA's overview webpage provides a summary of when you must disclose a notifiable transaction, as well as how to make the disclosure (i.e., through upcoming new Form RC312, *Reportable Transaction and Notifiable Transaction Information Return*) and by when, and the related penalties for non-disclosure or late filing.

It is also noted that the list of designated notifiable transactions will be linked to the webpage once designated.

Reportable uncertain tax treatments

New rules requiring larger corporations to report to the CRA all "reportable uncertain tax treatments" are introduced in new section 237.5 of the Act.

More specifically, Bill C-47 introduces a requirement for specified corporate taxpayers to report particular uncertain tax treatments under the Act to the CRA.

In general terms, an uncertain tax treatment is a tax treatment used, or planned to be used, in an entity's income tax filings for which there is uncertainty (in the relevant financial statements) about whether the tax treatment will be accepted as being in accordance with tax law.

Under the new rules, a corporation will generally be required to report an uncertain tax treatment if:

- The corporation is required to file a Canadian income tax return for the taxation year;
- The corporation has at least $50 million in assets at the end of the last financial year (that ends before the end of the taxation year or that coincides with the taxation year); and
- The corporation or a related corporation has audited financial statements (prepared in accordance with International Financial Reporting Standards or other country-specific generally accepted accounting principles relevant for domestic public companies).

Prescribed information in respect of uncertain tax treatments (e.g., the amount of taxes at issue) will be required to be reported at the time a corporation's Canadian income tax return is due.

Guidance from the CRA

The overview webpage provides a summary of when you must disclose a reportable uncertain tax treatment, as well as how to make the disclosure (i.e., through new Form RC313, *Reportable Uncertain Tax Treatments*) and by when, and the related penalties for non-disclosure or late filing.

The following information outlined on the CRA's guidance webpage is of particular interest in applying the new rules:

- If a matter with respect to a reportable uncertain tax treatment has already been disclosed to the CRA through official filings, such as a notice of objection, an advance income tax ruling, tax court procedures, or a previously filed Form RC312 or Form RC313, the disclosure requirements can be satisfied by referencing and attaching the previously filed documents in the descriptive areas of Form RC313.

- If a reportable uncertain tax position is included on the balance sheet of an entity's audited financial statements, it should be reported on Form RC313 even if the amount has been reported in previous years; if the amount is reversed in the year, then it is not required to be reported on Form RC313 (even if it is included in the comparative amounts on the financial statements).
- Additional guidance is also provided, for example, on situations where the reporting corporation is using the equity method, has partnership interests or uses functional currency in its books and records.

Reassessment periods

Bill C-47 provides that where a taxpayer has a mandatory disclosure requirement in respect of a transaction relevant to the taxpayer's income tax return for a taxation year, the taxpayer's normal reassessment period will not commence in respect of the transaction until the taxpayer has complied with the reporting requirement. As such, when a Form RC312, *Reportable Transaction and Notifiable Transaction Information Return*, or Form RC313, *Reportable Uncertain Tax Treatments*, is not filed, an assessment or reassessment for the respective transaction(s) can be made any time for up to four years after filing, or three years after filing for Canadian-controlled private corporations and individuals.

The links to Revised Form RC312 and Form RC313 have yet to be provided on the mandatory disclosure overview webpage.

As such, the taxation year will not become statute-barred until all the requirements under the mandatory disclosure rules are satisfied.

Penalties

Bill C-47 introduces various penalties for non-compliance with the mandatory disclosure requirements, and these penalties may be significant.

For reportable or notifiable transactions, a penalty of $500 per week, up to a maximum of the greater of $25,000 and 25% of the tax benefit, will apply for the failure to report a transaction by a taxpayer who enters into the transaction or who receives a tax benefit as a result of the transaction.

For corporations that have assets with a total carrying value of $50 million or more, this penalty is increased to $2,000 per week, up to a maximum of the greater of $100,000 and 25% of the tax benefit.

For promoters or advisors of reportable or notifiable transactions (or other persons who do not deal at arm's length with promoters or advisors and who receive a fee in respect of the transaction), the penalty for each failure to report a transaction will be equal to the total of $10,000, 100% of the fees charged by the promoter or advisor (or other person), and $1,000 per day, up to a maximum of $100,000, for each day the failure continues.

For corporations required to report uncertain tax treatments, the penalty for each failure to report a particular treatment will be $2,000 per week, up to a maximum of $100,000.

The penalties in relation to reportable transactions and reportable uncertain tax treatments are subject to a due diligence defence similar to that discussed above with respect to notifiable transaction reporting.

Next steps

The new mandatory disclosure rules are complex, and while guidance is provided in the Department of Finance explanatory notes and on the CRA's webpages, there may be ambiguity in applying the rules in certain circumstances. In addition, the 90-day reporting deadlines for reportable transactions and notifiable transactions may be challenging for taxpayers, promoters and advisors to comply with, especially if multiple disclosures are required and several parties are involved in the transaction or series of transactions.

While the CRA specifically notes on its webpage that its approach to the application of the mandatory disclosure rules will evolve over time based on its experience with specific factual situations, until further guidance is available, taxpayers, promoters and advisors are advised to proceed with caution in assessing their reporting obligations to mitigate the risk for penalties and interest.

Learn more

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