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MANDATORY DISCLOSURE RULES

2023 CPTS Fall Lecture Series

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Agenda

- Introduction
- Public policy rationale
  - BEPS Action 12
- Reportable transaction rules
  - Rules, interpretative issues, CRA guidance, Form RC312, examples, early experiences
- Notifiable transaction rules
  - Rules, interpretive issues, CRA guidance, Form RC312, examples, early experiences
- Reportable uncertain tax treatment rules
  - Rules, interpretive issues, CRA guidance, Form RC3133

Introduction

- Bill C-47 received Royal Assent on June 22, 2023
- Reportable transaction rules
  - A transaction or series of transactions with a tax benefit and at least one hallmark (contingent fee, confidential protection or contractual protection)
- Notifiable transaction rules
  - Transactions designated by the government as notifiable transactions
- Reportable uncertain tax treatment rules
  - The financial statements reflect an uncertain tax position

Public Policy Rationale

Public Policy Rationale for the Mandatory Disclosure Rules

➢ BEPS Action 12 - Objectives

- Increase transparency by providing early information to tax authorities on aggressive or abusive transactions
- Identify the promoters and users of aggressive or abusive transactions
- Deterrence

Public Policy Rationale for the Mandatory Disclosure Rules

➢ BEPS Action 12 – Key Design Principles

- The rules should be clear and easy to understand to:
  - avoid inadvertent failures to disclose
  - avoid poor quality/irrelevant information and undue administrative burden on tax authorities
- Balance taxpayer compliance costs with benefits to tax authorities
- Effective identification of schemes, users and promoters
- Effective use of the information collected

Reportable Transaction Rules
s. 237.3

The Old Reportable Transaction Rules

➢Old Rules

- Applied to an avoidance transaction which satisfied 2/3 hallmarks
- Taxpayers who benefited, participants for benefit of another, advisors, and promoters were required to file an information return to report the transaction
- Filing deadline – June 30 of the following calendar year
- Penalties limited to certain fees payable to the advisor or promoter
- Deemed GAAR abuse (until form is filed and penalties and interest are paid by person who obtained tax benefit)
- Extension of statute-barring period

➢Budget 2021

- The old reportable transaction rules were not "sufficiently robust"
  - Lack of timely, comprehensive and relevant information on aggressive tax planning strategies

The New Reportable Transaction Rules

➢Summary of the key changes

- Expanded scope
  - Lower threshold for an avoidance transaction to “one of the main purposes is to obtain a tax benefit”
  - Only one hallmark required (not two); however, the scope of the hallmarks has been narrowed to some extent
  - Filing required by all parties
- 90-day reporting deadline
- Increased penalties
- Broader statutory solicitor-client privilege exception

The New Reportable Transaction Rules

➢Who must report

- Taxpayers who benefit
- Participants for the benefit of another
- Advisors and promoters and non-arm's length persons, if they receive a contingent fee or fee for contractual protection
  - Solicitor-client privilege exception
  - Clerical / secretarial exception

The New Reportable Transaction Rules

- Reporting required if:
  - Avoidance transaction / series where one of the main purposes is to obtain a tax benefit
  - One of the following:
    - **Contingent fee** based on obtaining tax benefit or number of participants, or fee based on size of tax benefit (SR&ED exception)
    - Advisor/promotor obtains **confidential protection** re: tax treatment
    - **Contractual protection** in respect of the avoidance transaction / series to protect against loss of tax benefit or related dispute expenses
      - Exception for standard professional liability insurance
      - Exception for standard indemnities for pre-closing liabilities in arm's length sale of business that are not tax-motivated
- Exceptions for tax shelter / flow-through share schemes that already are reported (but subject to anti-avoidance rule)

The New Reportable Transaction Rules

- Reporting of series on one form removes the need to file a separate form for each transaction in the series
- Reporting is not an admission that GAAR applies or any transaction is part of a series

The New Reportable Transaction Rules

➢ When to report

- Form RC312 must be filed within 90 days of the earlier of a person entering into the transaction or becoming contractually obligated to do so

➢ Coming into force

- Applies to transactions entered into on or after June 22, 2023

The New Reportable Transaction Rules

➢ Consequences of a failure to report a reportable transaction

- Taxpayer/participant penalty if a corporation with assets > $50 million:
  - $2,000 per week to a maximum of the greater of $100,000 or 25% of the tax benefit
- Taxpayer/participant penalty in other cases:
  - $500 per week to a maximum of the greater of $25,000 or 25% of the tax benefit
- Advisor and promoter penalty:
  - fees charged + $10,000 + a maximum of $100,000 ($1,000 per day)
- Deemed misuse/abuse under GAAR until form is filed and penalties and interest are paid by person who obtained the tax benefit
- Limitation period for the assessment of tax and interest does not commence until Form RC312 is filed; no limitation period on penalty
  - Applies if anyone fails to report

➢ Statutory due-diligence exception

The New Reportable Transaction Rules

- Connection to proposed GAAR amendments
  - Reporting (required or optional) under s. 237.3 eliminates exposure to the proposed GAAR penalty

The New Reportable Transaction Rules

➢Interpretive issues

- Breadth of:
  - “transaction” and “series of transactions”
  - “tax benefit” and “avoidance transaction”
    - Recently amended definition of “tax benefit” in s. 245(1) is used
  - “contractual protection”
- Scope of solicitor-client privilege
- What if some entities/individuals involved in the series no longer exist?
- What if different parties take different positions?

The New Reportable Transaction Rules

➢CRA Guidance

- Released on July 6, 2023; modified on or around September 6, 2023
- To be updated on an ongoing basis
- Some key points:
  - Series that straddle June 22, 2023 are caught
  - Reporting by partners/employees of advisor/promoter firm not required if firm reports
  - Contingent fee does not include:
    - Collection of a standard fee for regular commercial transactions by a financial institution
    - Fee for claiming SR&ED credits
    - Fee for preparing tax returns that result in refunds
    - Fee for preparing tax returns / elections that is based on number of returns / elections
    - Value billing (other than where value is based on tax benefit)
    - Contingent litigation fee, unless obtained prior to conclusion of series
  - Confidential protection does not include protection of trade secrets

The New Reportable Transaction Rules

➢CRA Guidance

- Contractual protection does not include:
  - Limitation of liability (for negligence) clause in standard engagement letter
  - Professional liability insurance
  - Standard representations, warranties, guarantees between vendor and purchaser, and traditional representations and warranties insurance policies, in ordinary M&A to protect against pre-sale liabilities (including tax liabilities)
  - Insurance on arm's length sale of business to protect against pre-sale liabilities, including for pre-closing tax issues or the amount of existing tax attributes
  - Indemnities for bump covenants for public companies
  - Tax insurance for TCP issues on sale
  - Indemnity for safe income strip calculation
  - Price adjustment clauses
  - Advance tax ruling from the CRA
  - Contingent litigation fee after completion of series
  - Indemnity on establishment of RRSP

The New Reportable Transaction Rules

➢ Form RC312 – Reportable Transaction and Notifiable Transaction Information Return
  - For reportable transactions, requires disclosure of:
    - fees (in certain cases)
    - description of reportable transaction
    - date of required disclosure
    - names of all advisors/promoters
    - which hallmarks apply
    - the tax benefit, actual or estimated, obtained or being sought (incl. the amount and nature of the tax benefit, whether it is recurring, and in which taxation years the tax benefit is expected to be used)
    - details of the transactions (*e.g.*, a step-by-step description of the series of transactions, promotional documents, organizational charts)
    - the "legislative provisions applied"

The New Reportable Transaction Rules

➢Examples

- Example 1: An agreement to file a s. 85 election
- Example 2: s. 55(3)(b) butterfly covenants vs. s. 88(1)(d) bump covenants

The New Reportable Transaction Rules

➢ Early experiences

- Watch out for series of transactions which straddle June 22, 2023
  - The reporting requirement is triggered with the first reportable transaction entered into after Royal Assent
  - “Transaction” and “series of transactions” are broad concepts
  - Should not open previously statute-barred years in which tax benefits were realized
- The breadth of contractual protection has been a significant interpretive issue
  - Any form of protection that protects a person against a failure of the transaction or series to achieve a tax benefit from the transaction or series
  - Some relieving examples in the CRA guidance released to date, but watch for additional CRA guidance on “acceptable” transactions

The New Reportable Transaction Rules

➢ Early experiences

- Solicitor-client privilege
  - Recent injunction suspends the application of the rules to lawyers
  - Scope of solicitor-client privilege in the context of the form
- Cooperation clauses
- General trend to be conservative and disclose where there is doubt
- Critical for the tax group to be involved early and regularly in both internal and arm's length transactions

Notifiable Transaction Rules
s. 237.4

The Notifiable Transaction Rules

➢Who must report

- Taxpayers who benefit
- Participants for the benefit of another
- Advisors and promoters and non-arm’s length persons, if they receive a fee
  - Solicitor-client privilege exception
  - Clerical / secretarial exception
  - “Reasonably be expected to know” exception
  - Reporting by partners/employees of advisor/promoter firm not required if firm reports

The Notifiable Transaction Rules

➢Reporting required if:

- Series includes a notifiable transaction from which a tax benefit results or is expected to result
- A notifiable transaction is a transaction designated by the Minister of National Revenue with the concurrence of the Minister of Finance, or a substantially similar transaction
  - February 2022 Backgrounder seems to designate:
    - Manipulating 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

The Notifiable Transaction Rules

➢ Reporting (continued):

- Broad definition of substantially similar
  - Same or similar tax consequences and that is either factually similar or based on a similar strategy
  - To be interpreted broadly in favour of disclosure

The Notifiable Transaction Rules

- Reporting of series on one form removes the need to file a separate form for each transaction in the series
- Reporting is not an admission that any transaction is part of a series

The Notifiable Transaction Rules

- **When to report**
  - Form RC312 must be filed within 90 days of the earlier of a person entering into the transaction or becoming contractually obligated to do so
- **Coming into force**
  - Applies to transactions entered into on or after June 22, 2023

The Notifiable Transaction Rules

- Consequences of a failure to report a notifiable transaction
  - Taxpayer/participant penalty if a corporation with assets > $50 million:
    - $2,000 per week to a maximum of the greater of $100,000 or 25% of the tax benefit
  - Taxpayer/participant penalty in other cases:
    - $500 per week to a maximum of the greater of $25,000 or 25% of the tax benefit
  - Advisor and promoter penalty:
    - Fees charged + $10,000 + a maximum of $100,000 ($1,000 per day)
  - Limitation period for the assessment of tax and interest does not commence until Form RC312 is filed; no limitation period for penalty
    - Applies if anyone fails to report
- Statutory due-diligence exception for taxpayers and participants only

The Notifiable Transaction Rules

➢ Interpretive issues

- Breadth of “series of transactions”
- Have the sample transactions in the February 2022 backgrounder been designated? What is the impact of proposed amendments since then (*e.g.*, substantive CCPC rules)?
- Breadth of designated transaction descriptions and substantially similar definition
- Designation after transaction completed
- Scope of solicitor-client privilege
- What if some entities/individuals involved in the series no longer exist?
- What if parties take different positions?
- Does the common law due diligence defense apply to advisors, promoters and non-arm’s length persons?

The Notifiable Transaction Rules

- CRA Guidance
  - Interpretation of the “reasonably expected to know” exception
    - Investment banker who played leading role has to report
  - Due diligence exception is met by asking advisors and being advised that no such reporting obligations will arise
  - Notifiable transactions will be listed on a CRA webpage

The Notifiable Transaction Rules

- Form RC312 – Reportable Transaction and Notifiable Transaction Information Return
  - For notifiable transactions, requires disclosure of:
    - fees (in certain cases)
    - date of required disclosure
    - reference number of designated transaction
    - if it is the same as or substantially similar to the designated transaction
    - whether tax benefit is recurring and when it is expected to be used
    - the reason for disclosing the notifiable transaction
  - If a transaction is notifiable and reportable, CRA guidance says to just complete notifiable transaction reporting
  - Less detailed reporting required for notifiable transactions

The Notifiable Transaction Rules

➢ Example

- Historical indirect transfer of property to a non-resident under s. 107(2); are any current transactions part of the series?

The Notifiable Transaction Rules

➢ Early experiences

- Watch out for series of transactions which straddle June 22, 2023
  - Should not open previously statute-barred years in which tax benefits were realized
- Solicitor-client privilege
  - Recent injunction suspends the application of the rules to lawyers
  - Scope of solicitor-client privilege in the context of the form
- Cooperation clauses
- General trend to be conservative and disclose where there is doubt

Reportable Uncertain Tax Treatment Rules
s. 237.5

The Reportable Uncertain Tax Treatment Rules

➢Who must report

- A “reporting corporation”, which is a corporation that:
  - has audited financial statements for the corporation or a consolidated group to which the corporation belongs prepared in accordance with IFRS or country-specific GAAP for public companies;
  - has assets > $50 million; and
  - is required to file a Canadian tax return.

The Reportable Uncertain Tax Treatment Rules

- **Reporting required if:**
  - The reporting corporation has a reportable uncertain tax treatment ("**RUTT**") in its financial statements
  - A RUTT means a tax treatment of the corporation in respect of which uncertainty is reflected in the financial statements
    - Very broad definition of tax treatment – treatment reported in a return of income or information return and includes a decision not to include an amount in a return of income or information return
    - Under accounting standards, the taxpayer does not have a better view opinion
      - Could result from a change in the law
- **Reporting is not an admission that the tax treatment is not in accordance with the Act or any transaction is part of a series**

The Reportable Uncertain Tax Treatment Rules

➢ When to report

- Form RC3133 must be filed before the filing-due date for the taxation year

➢ Coming into force

- Taxation years that begin after 2022, except the penalty does not apply to taxation years that begin before June 22, 2023

The Reportable Uncertain Tax Treatment Rules

- Consequences of a failure to report a reportable transaction
  - Penalty up to $2,000 per week to a maximum of $100,000
  - Limitation period for the assessment of tax and interest does not commence until Form RC3133 is filed; no limitation period for penalty
- Statutory due-diligence exception

The Reportable Uncertain Tax Treatment Rules

- Interpretive issues
  - Reporting in respect of foreign tax uncertainty
  - Scope of solicitor-client privilege

The Reportable Uncertain Tax Treatment Rules

➢CRA Guidance

- RUTT should be reported each year it is reflected in the financial statements, even if it relates to an older year
- Guidance on situations involving equity method of accounting and partnerships
- Reporting must be in Canadian dollars, even if functional currency election made
- Consolidated reporting on RC3133 not permitted – each corporation must report
- Reporting only required for RUTTs related to Canadian income tax under ITA

The Reportable Uncertain Tax Treatment Rules

➢CRA Guidance

- Tax year to which RUTT pertains means the year in which taxable income is affected
- Requirement applies to short tax years
- If financials prepared under multiple accounting standards, a RUTT under any of them will need to be reported
- If information has been filed with CRA previously in official filings, can attach those filings to RC3133 in lieu of a more detailed description

The Reportable Uncertain Tax Treatment Rules

- Form RC3133 – Reportable Uncertain Tax Treatment Information Return
  - Requires disclosure of:
    - tax year to which the RUTT pertains
    - applicable legislative provisions
    - RUTT amount in Canadian dollars
    - whether it is temporary or permanent
    - whether it involves tax attributes
    - whether it involves property valuation
    - whether it is international or domestic
    - description of the relevant facts and tax treatment
    - whether there are official CRA filings or an RC312 has been filed

Thank You For Joining Us

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