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CROSS-BORDER TAX PODCAST SERIES

Episode 15: An overview of changes to mandatory disclosure rules – LIVE in Toronto

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Hi, this is Paul Walker.

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And you are listening to BDO's Cross-Border Tax Podcast live.

Today, this afternoon, Chris and I are going to talk about the whole new mandatory disclosure regime and what does this mean? What's happening? How do you fit in, how do you not fit in, and what are the reporting and penalties and things in the like that you have to worry about?

I'll first cover the mandatory disclosures on reportable transactions. Chris will look at the notifiable transactions, which is slightly different, and then also the surprising uncertain tax positions and how that will affect clients that have those positions in their audited financial statements.

With these rules, essentially what's going on is finance wanted a system where they would get information sooner than later on your normal filing requirements. They want to have that information at hand so that they could assess aggressive transactions or transactions that were risk transactions.

Lo and behold, the rules that we have in place are overstepping of that. They're more wide, they're more broad, and they do capture things that are not aggressive. It's any transaction if you meet certain conditions.

These newer rules, which override the older rules, have come into play to be able to have CRA to have that ability to obtain that information in more detail and have it earlier so they can assess how they want to assess tax risk with those transactions.

These transactions came into place effectively for June 21st, 2023. They're for the notifiable and reportable transactions that occur after June 21st, 2023.

It's also for transactions that will straddle that period. For example, a person enters into a series of transactions before the 21st of June, and those transactions go into after June 22nd. The minute that they have a transaction that is reportable or notifiable within that period after the 22nd, they're in the rules to report that transaction as one of the transactions in the notifiable reportable transactions.

What I would say about these rules on the side is that the joint committee made a very specific comment that these rules were intended to be mirrored to the global rules that are coming into place with these types of reporting transactions. They've made note of, and if you pull up the joint committee report and the appendix of the report, they make a note that the OECD commentary is that the Canadian rules are over and above the rules that were originally being noted by the OECD.

How do you get in these rules? What are these mandatory disclosure rules? we've been through sort of a period of legislation, fixed legislation, then a period of commentary legislation coming into place, and now we're getting into positions where legislation is in place and people are reporting transactions.

There's two criteria.

The first is that you have to meet one of the three hallmarks. The hallmarks being a contingent fee arrangement, confidential protection, and a contractual protection. But you also have to have an avoidance transaction. The avoidance transaction is that it can be reasonably that it's one of the main purposes. That's a key, one of the main purposes.

A lot of our anti-avoidance rule, the new guards moving towards this, one of the main purposes instead of the primary purpose or a primary purposes for another valid purpose, which are baked in the old mandatory disclosure rules, which specifically talked about you had to meet two of the hallmarks. Now you only meet one, and that the avoidance transaction had to be something that was other than... You are carved out if it was other than for a primary purpose that was not primary for a tax benefit.

Again, they've also put in place the reporting, which used to be reporting when you filed your tax return to now this period much, much earlier, which we'll talk about in a second.

Okay. Looking at these hallmarks, I'll go through each three hallmarks.

There's the contingent fee hallmark. Just flat out, the contingent fee hallmark, and I don't have this list on the slide, but the hallmark is effectively, if your fee is based on the tax benefit, you fail. If the contingent fee, or if there's a contingent fee to obtain a tax benefit or failure to obtain a tax benefit, okay, you fail, you've met the hallmark. Or if it's attributed to a number of taxpayers. So a tax plan gets in place and it's going to be this much, this much, this much, because every taxpayer that's added on, it's another fee, another amount, and another amount for that taxpayer. You would fail this hallmark.

But we have some comfort in that there is some CRA commentary and they talk about situations with financial institutions and the normal commercial business and that fees are charged in those particular circumstances, or now it's legislative that a fee for SR&ED, Scientific Research and Development type expenditures, a contingent fee in that range, those are allowed into the rules. Fees that are based on number of preparation filings. As I was talking about before, if the fee is based on the number of people involved, it's attributed to the number of people. This is a different look at it. This is where, say you've got to file section 85 rollover Form, T2057, so you've got 20 taxpayers, it's going to cost X amount per form. That's been said as being okay.

Then there's this concept of value billing and whether value billing is allowed. CRA has made some commentary that value billing would in general be allowed, but the value billing cannot be based on the tax benefit. It's got to be based on some other criteria. So criteria about the level and timing of experience of the person doing the work. The time that it takes for the people that are doing the work adds up to what they're billing. The degree of risk and the responsibility undertaken to do the work, the priority and importance of the work to the client, and then the value that the client is actually getting from that transaction would be valid other criteria to be included in value billing. So we've got a little bit more comfort in that part of it.

The next hallmark would be the confidentially hallmark. This is the more simple one. Basically it's a hallmark that says that you can't have confidentiality in your tax plan or your tax structure that specifically says that other people can't access it and see it. More specifically, Revenue Canada doesn't have access to see that transaction, something that prohibits CRA from seeing it.

Without having those types of hallmarks in there, you should be okay. But if you've got that hallmark, obviously it's a pretty small one to look at, you'd hit there. But CRA has made comments that it doesn't relate to normal IP and trademarks and things like that that don't have a tax element to it, that they would allow confidentially for that. But advisors are cautioned to review with legal counsel their engagement letters and make sure that there's nothing in those engagement letters that could just simply trigger this hallmark, because this hallmark would trigger it for all the parties involved in the transaction.

The next hallmark is the contractual protection hallmark. Essentially this is a hallmark that provides some sort of insurance or protection against the failure of the transaction happening, the tax benefit not happening, or payments for expenses and reimbursements of expenses, interest and penalties that might be incurred by a person in the course of a dispute in reporting that tax benefit. CRA has obviously come back with some commentary on what does not include, so a limited liability clause in a professional engagement letter. Thank goodness. We're happy to see that.

Standard reps and warrants in a normal purchase and sale agreement, traditional reps and warrants that would go into those agreements, or some sort of contractual liability protection for liabilities that might exist in the business prior to the sale of that business. Those are all okay.

There's standard price adjustment clauses, advanced income tax rulings, contingent litigation fee arrangements in relation to the appeal of a tax assessment. So that's something post. If your lawyer that takes on, or tax advisor, you take on work to help with an appeal and it's contingent based on that appeal and you weren't involved in the original transaction, presumably you should be okay to have a contingent fee arrangement in that area.

A regular purchase and sale agreement, you've got CDA protections, you've got excessive eligible dividend exceptions, safe income calculation exceptions, things of that nature. Will those trigger the reportable transaction? We're not too sure yet. It will be seen how these rules pan out.

Okay, so who must disclose? A person who gets the benefit obviously has to disclose. A person who enters into the reportable transaction on behalf of that person would have to disclose. A promoter or an advisor who's entitled to a fee for that transaction, they will have to disclose. If you meet one of the hallmarks, you would have to disclose as a promoter or an advisor. Or a person who does not deal at arm's length with that advisor and promoter.

One thing in the changes of the rules, how they've panned out, there was a provision in the reportable transactions that said that if somebody didn't report, all those that were supposed to report are jointly and separately liable for the penalties. That provision, thankfully, has been taken out. It's on an advisor by advisor, person by person responsibility to report and it doesn't affect other people if that person, or that group, does not report. So that's a good thing. But the one thing that didn't change is the definition of an advisor. It's very, very broad. It can capture anybody that provides assistance, advice for creating, developing, planning, executing and implementing that transaction, and probably could go as far as the prepare of the tax return that puts those transactions through a tax return. The advisor piece is very broad, so buyer, beware and make sure that you understand that.

For the separate reporting, as long as there's not a confidentiality hallmark within the transaction, as long as you as the visor don't have a contractual protection, or you don't have a fee arrangement that puts you in the hallmark, presumably you should be okay and that you wouldn't have to report that transaction, even though somebody else might have to report that transaction.

What's the timeline? Chris may talk about this a little bit more, but the new form RC312 is about 13, 14 pages long. It looks like you can check boxes and fill out a few things in it, but it's very extensive. Effectively, you'll have to report the transactions if you're reporting the step plan and that you do need legal council and things of that nature. It's very intrusive. It's a very long form. It would take a significant amount of time and undertaking to fill the form out.

As I said, the timelines were 45 days as opposed to filing with your income tax return for the old rules. That's now been extended. Now you have a 90-day window, which is very helpful, although you're still reporting information quite early to Revenue Canada. That 90 days starts at the time you enter into a transaction, or 90 days from you become contractually obligated to enter into that transaction.

Why is this important? Well, the penalties. Penalties for failure for late filing, if you look at a larger corporation, $50 million in carrying value of assets, it's a $2,000 weekly penalty for late filing, to a greater of a hundred thousand dollars or 25% of the tax benefit obtained. Large, large penalties. All of the taxpayers, those that don't meet the large $50 million thresholds, $500, it's a greater $25,000, but again, 25% of the tax benefit that's being obtained.

The reassessment period doesn't start until you file. That could be four years, or if you're a CCPC or an individual, it's your normal three-year period. It's important that you understand the statute-barred period and filing on time.

For promoters and advisors, the penalties' a little bit different. It's a hundred percent of your fees, so whatever you charged, that's the first party penalty, plus $10,000, plus a thousand dollars each day for failure to report that transaction, up to a maximum of a hundred thousand dollars. So you're looking at as an advisor, $110,000, plus your fee.

There were some comments from the joint committee that went through that did not get addressed by the updated legislation or CRA commentary to date. I checked the website yesterday and October 10th was the last time they updated it, but you actually can't see what they updated on their website. It's got a box for new, but that was something that was updated in September.

But what the joint committee has come back with is there's no materiality for these mandatory disclosure rules. If you look at the OECD model and you look at other countries like the UK, there are thresholds where you get into the reportable transaction. We don't have that here in Canada. Any transaction, if you trip a hallmark and it's an avoidance transaction, which is an easy test to trip up on, you would be in these reporting rules. Again, definition of advisor, they did ask for the advisor definition to get more granular of what an advisor is and the role that the various advisors play in, and that has not been addressed in the new rules to date.

With that, I will turn it over to Chris on notifiable.

Chris Rathwell:

Thanks, Paul.

Notifiable transactions - I think you're going to see that the concept of a notifiable transaction really piggybacks on almost everything that Paul mentioned earlier. The reportable transactions, there's a series of tests that need to be met. The notifiable transactions piggyback on a lot of those rules with the caveat that the minister now has language in the Income Tax Act that says a transaction is notifiable if it is the same or substantially similar to one that they designate. And then the logical question that falls out of that is what is substantially similar in the CRA opined? Substantially similar includes effectively some GAAR language in there. Are you expected to obtain the same or similar tax consequences?

They also note that this is to be interpreted broadly in favor of disclosure. It's quite an onerous regime in a lot of ways when you think about it if they're baking language in there that effectively works to their favor.

The Minister of Revenue can designate these transactions. So not just finance, it's actually the Minister of National Revenue that can designate transactions in concurrence with the Minister of Finance.

Okay. In terms of notifiable transactions, very similar. Who has to disclose? Same as reportable transactions, with a caveat that the legislation does provide an exemption for information that is protected by solicitor-client privilege.

In terms of protecting yourself if your corporation or you're going to be party to a notifiable transaction. Well, how can you protect yourself against the application of penalties that Paul discussed, and I will touch on again in a moment. Well, if it's based on this concept of reasonable expectation to know, and what is a reasonable expectation to know? Well, only advisors who know or reasonably expected to know of the reporting requirements they're required to file. I don't really know what that means. It's kind of circular, but it is what it is. That's the guidance we have.

But they have given us some examples here. Who's an advisor that's expected to report these things? They try and carve out advisors who provide ancillary services or have narrow mandates that I guess don't technically understand the transaction as a whole. I don't know how much comfort that gives anybody, but that's the commentary that we have.

How do you protect yourself from a due diligence perspective? The CRA has got some additional commentary out there where they say the person who's obtained the tax benefit would generally meet their due diligence obligations if they ask their advisor whether it's a notifiable transaction or not. Now, I guess the interesting caveat there, which Paul's touched on, is how many advisors do you need to consult, because the definition of advisor is quite broad? So you could have multiple advisors at multiple stages of a transaction that you need to consult.

Okay, notifiable transactions, again, disclosed on the same form as the reportable transactions. As Paul noted, the disclosures on this form are actually quite extensive. If you haven't looked at the form before, because they came out relatively recently, I would encourage you to take a look. It's intrusive, I guess is how I would describe it. But maybe the minister of finance feels differently. Same due dates, as it's the same form. Again, same penalties and same comments on reassessment period for a notifiable transaction.

I've discussed notifiable transaction and referenced that it piggybacks on the notion of reportable, but the logical question that everybody probably has is, well, what is a notifiable transaction? The answer to that is, we don't know because the minister has reserved the right to provide a list, but they haven't provided a list and they haven't told us the form that list is going to take. They haven't told us where they're going to keep it, how they're going to update it, how they're going to remove things from it. It's quite a large gap in a fair amount of uncertainty as to how we're going to be able to move forward with these rules, but I guess at the end of the day, there's been a number of issues identified by the joint committee because of that.

In terms of the joint committee, the questions that are really outstanding are A, how are you going to provide us with this list of notifiable transactions? B, are you going to give us some commentary or guidance on what constitutes substantially similar? Substantially similar is broadly a GAAR concept. There's voluminous amounts of guidance in that regard, but we don't have any in terms of notifiable transactions.

The last question is, if you have a series of transactions, well, what is the triggering point for the notifiable transaction? When do you have to identify it and disclose it as such? It's not clear based on the commentary we have when that is, but the joint committee has proposed that the best triggering point to trigger notification to the Canada Revenue Agency would be at the time this would benefit from this notifiable transaction is realized.

Moving on from notifiable transactions, there's a concept of reportable uncertain tax treatments. Similar to what Jessica was alluding to with the EIFFEL rules and the importance of audited statements and all of that good stuff that gets baked in there, now the CRA is coming after your tax provisions as well. An uncertain tax treatment is defined as an amount used or planned to be used in an entity's income tax filings for which there is uncertainty over whether the tax treatment will be accepted as being in accordance with tax law. All the dinosaurs like me immediately start thinking back to the US FIN 48 rules and how those have evolved over time. I guess the concept here is broadly similar.

The reporting mechanism itself is RC313, so a similar form to the one we discussed for reportable and notifiable transactions, but slightly different.

When do these things need to be reported? Well, the amount reported, it needs to be reported if it is new in the year, or it has been reported in previous years.

Unlike CRA past practice, which was reporting at once and you're done, you need to refresh these uncertain tax treatments and you're reporting to them. Again, if you take a look at this form, you'll see very clearly that that's how they've structured the form. You're effectively disclosing each uncertain tax treatment on a line by line for each one.

Commentary from the CRA that has come out in terms of the equity method of accounting exists, as well as partnerships. Partnerships in particular were an interesting case. The question was, well, do you need to disclose uncertain tax treatments with regards to partnership interests? The CRAs come back with an administrative position that if the reporting corporation meets the criteria, then any uncertain tax positions in the partnerships should also be included on that corporation's reporting form.

No consolidated reporting. Each entity is required to file its own form. In terms of what has to be captured on these forms, the CRA has given us some clarity that it's restricted to income tax items. There's no need to disclose uncertain tax treatments for indirect taxes, provincial taxes, or foreign taxes.

There was some questions about, well, what if I have a short taxation year for whatever reason? I have an amalgamation acquisition of control. The commentary that the CRA has given is that that short taxation year also requires filing of the form for uncertain tax treatments.

When do you have to disclose uncertain tax treatments? The thresholds are actually pretty low. You have to file a Canadian income tax return. The entity is 50 million in assets at the end of the financial year. It prepares audited financial statements in accordance with IFRS or country-specific GAAP. And obviously there's uncertainty as to a tax treatment in those statements.

This is broadly dissimilar, or at least the threshold is significantly lower than what's happening again in the UK where the thresholds are up over 200 million. Canada's gone quite low and cast quite a wide net with regards to uncertain tax treatments.

How do you disclose it? Again, RC313. The due date for this particular form, unlike reportable and notifiable where you have 90 days, this one is due on or before the corporate income tax return deadline. The penalties are similar, but they're $2,000 a week to a maximum of a hundred thousand dollars. But that's for each uncertain tax treatment. If you have multiple uncertain tax treatments, you can walk into multiple penalties of up to a hundred thousand dollars and a similar reassessment period.

In terms of issues identified by the joint committee, the first one is really... Giving the CRA subjective information on tax risks without safeguards might discourage practitioners from preparing that information at all, but I guess it is what it is at this point.

Similar to what we discussed with reportable and notifiable transactions, there's no de minimis threshold. If there is an uncertain tax treatment baked into the financials material or not, it's captured by these rules and must be disclosed.

As we discussed earlier, the joint committee identified there's no exception for reporting amounts that the CRA is already aware of. Even if you've got amounts under objection, if you have amounts under appeal, you still have to report those on these forms. If they go unreported, you're subject to penalties and they come at you with a hatchet, I guess.

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