# Canada's mandatory disclosure rules

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# Canada's mandatory disclosure rules: an overview

This guide provides an overview of Canada's mandatory disclosure rules, which require taxpayers and, in some cases, advisors/promoters to file detailed information returns with the Canada Revenue Agency (CRA). These obligations can apply to non-resident persons as well as residents of Canada. The *Income Tax Act* (Canada) (the *Tax Act*) contains three sets of mandatory disclosure rules, requiring the reporting of (1) reportable transactions, (2) notifiable transactions and (3) reportable uncertain tax treatments.

# Reportable transaction rules

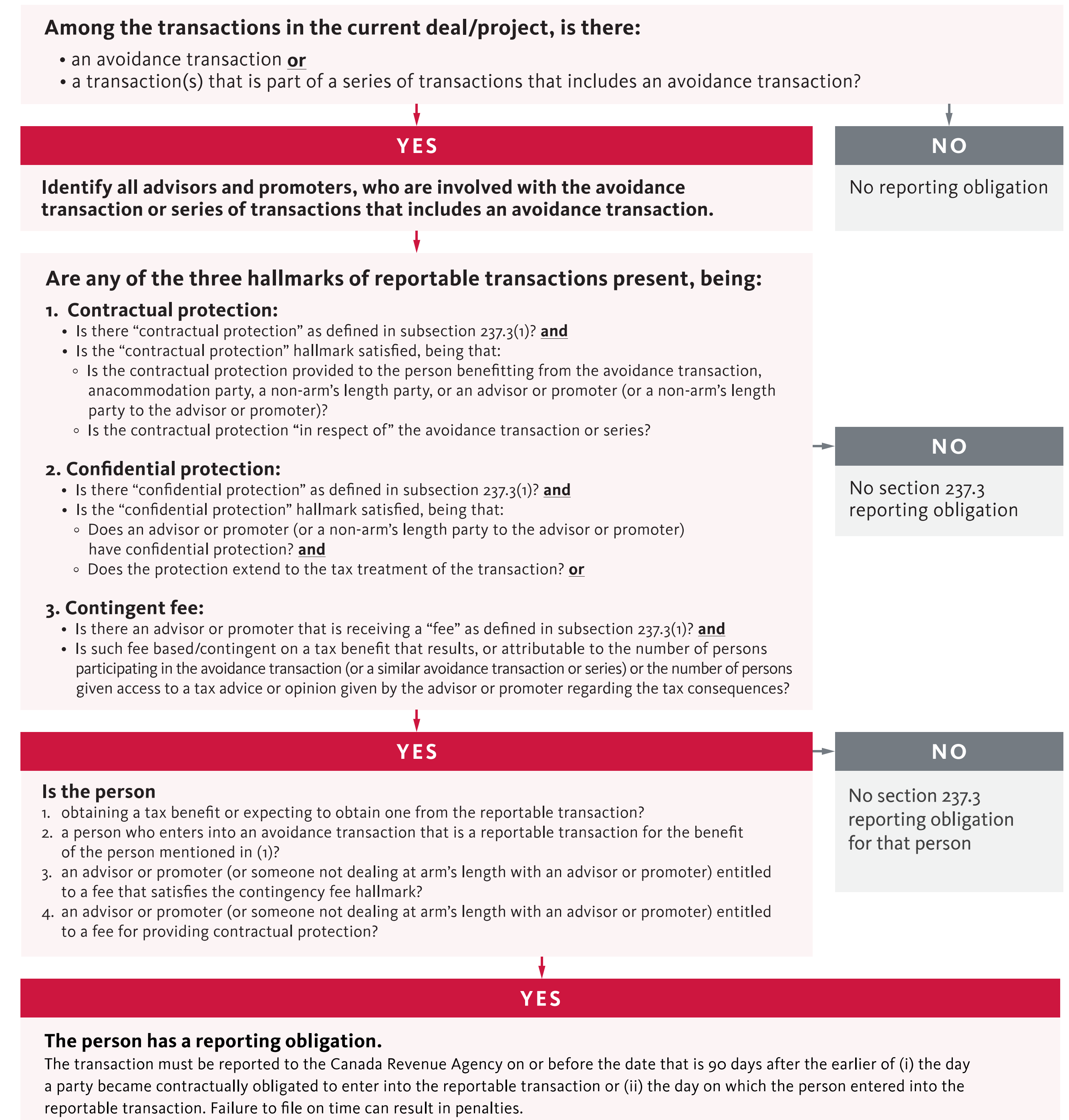
The reportable transaction rules require detailed reporting by taxpayers, promoters and advisors of "avoidance transactions" that bear characteristics (hallmarks) the government views as being indicative of aggressive tax planning.

The flowchart below provides a guide to assist in determining whether a transaction is subject to reporting obligations under the reportable transaction rules. Each step of the flowchart, as well as the operative concepts/terms, is described in further detail on the next page.

*"If the transaction or series of transactions is an avoidance transaction and at least one of the hallmarks is present, then a reportable transaction exists."*

FIGURE 1

## DETERMINING WHETHER A REPORTABLE TRANSACTION FILING IS REQUIRED



# Is there a reporting obligation? Understanding each step in the flowchart

## Is there an avoidance transaction?

"Avoidance transaction" is the first of two requirements for there to be a reportable transaction.

A transaction is defined broadly to include an arrangement or event.

A transaction is an "avoidance transaction" if it may reasonably be considered that one of its main purposes—or of the series of transactions of which it is a part—is to obtain a tax benefit. Whether a tax benefit results or is expected to result from the transaction or series of transactions is not sufficient to make it an "avoidance transaction". In addition, one of the main purposes of the transaction or series of transactions must be to obtain that tax benefit.

A transaction can have more than one "main" purpose.

Moreover, because an avoidance transaction includes a transaction that is part of a series of transactions, a taxpayer may be a party to an avoidance transaction even if none of the steps in which the taxpayer participates has obtaining a tax benefit as a main purpose.

If no avoidance transaction is present, including as part of a series that includes the facts one is considering, then there ought not to be any reportable transaction.

### Identify all advisors and promoters

When analysing whether any of the three hallmarks are present, it is important to identify all advisors and promoters in respect of the transaction or series of transactions. This is because each of the hallmarks can be triggered by the receipt of certain fees or types of protection by advisors or promoters. The terms are broadly defined and can, under some circumstances, catch transaction participants that one would not think of as advisors or promoters in the ordinary sense.

An "advisor" is defined to include a person who provides to another person

- any "contractual protection" (see below) in respect of the transaction or series of transactions; or
- any assistance or advice with respect to creating, developing, planning, organizing or implementing the transaction or series of transactions

A "promoter" includes each person who (1) promotes or sells an arrangement, plan or scheme if the arrangement includes or relates to the transaction or series of transactions, (2) makes a statement or representation that a tax benefit could result from an arrangement if the statement or representation was made in furtherance of the promoting or selling of the arrangement and the arrangement includes or relates to the transaction or series of transactions or (3) accepts consideration in respect of an arrangement referred to in (1) or (2).

The last category, (3), presumably has to be read contextually to include only consideration received in respect of tax schemes that are promoted or marketed as generating tax benefits.



## Are any of the three hallmarks present?

The second requirement for there to be a reportable transaction is that at least one of three hallmarks be present in respect of the avoidance transaction (or series of transactions that includes the avoidance transaction): contractual protection, confidential protection and a contingent fee.

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### Contractual protection hallmark

*Contractual protection* means any form of insurance or other protection, including an indemnity or guarantee, that protects a person if the transaction or series of transactions fails to achieve a tax benefit or pays for or reimburses any expense, tax, interest, penalty or similar amount.

The definition of "contractual protection" in subsection 237.3(1) carves out legal protection that is integral to a contract between persons acting at arm's length in respect of a direct or indirect business transfer where it is reasonable to consider that the relevant insurance or protection is

- intended to ensure that the purchase price accounts for any pre-closing liabilities of the purchased business
- obtained primarily for purposes other than to achieve a tax benefit from the transaction or series

Referring to the above carve-out, a guidance document on the mandatory disclosure rules published by CRA (the CRA Guidance) states that a reporting obligation would not arise solely in respect of protection in the following, non-exhaustive list of examples:

- indemnities relating to existing pre-closing tax issues or existing tax attributes
- certain contractual covenants and indemnities provided by a target company to a purchaser that relate to the availability of a paragraph 88(1)(d) step-up (bump) by the purchaser of the tax basis non-depreciable capital property owned by the target
- tax insurance or other protection obtained in relation to the purchase of "taxable Canadian property" from a non-resident
- pre-sale transactions involving payment of intercorporate dividends to a holding company
- indemnities or covenants to a purchaser and/or target in respect of Part III tax liabilities and other adverse tax consequences arising from dividends paid as part of a pre-closing reorganization

The contractual protection hallmark is met where "contractual protection" is provided in respect of the avoidance transaction to (1) a person who entered into the transaction or for whose benefit the avoidance transaction was entered into; (2) any person who entered into the avoidance transaction for the benefit of, or does not deal at arm's length with, a person described in (1); or (3) an advisor, a promoter or any person who does not deal at arm's length with an advisor or promoter.

It is possible for contractual protection (as defined) to be present but for the hallmark not to be satisfied, either because the contractual protection is not provided to one of the enumerated types of persons or because it is not "in respect of" an avoidance transaction. For example, the CRA Guidance states that the contractual protection hallmark is not triggered where the "avoidance transaction" is the establishment of a registered retirement savings plan (RRSP) but the contractual protection is in respect of a different type of transaction (such as the making of non-qualified investments).

In addition to those listed above, the CRA Guidance contains a number of examples of protection arising in normal commercial or investment contexts that the CRA would not treat as triggering the contractual protection hallmark—for example, indemnity and gross-up clauses relating to withholding taxes in credit agreements and ISDA documents.

The CRA does not always make it clear in the guidance whether a given example is illustrative of a more general principle. Consequently, taxpayers and advisors must exercise judgment in gauging the extent to which they can rely on the examples in analogous but not identical circumstances.

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### Confidential protection hallmark

*Confidential protection* in respect of an avoidance transaction refers to anything that prohibits disclosure to any person of the details of the structure of the transaction or series under which a tax benefit results. Although the defined term is broad, the corresponding hallmark is narrower.

The confidential protection hallmark is met if

- an advisor or promoter (or a person who does not deal at arm's length with the advisor or promoter) obtains confidential protection
- the confidentiality relates to a tax treatment in relation to an avoidance transaction

Thus, even if in connection with an avoidance transaction there is "confidential protection" as defined, the hallmark will not be triggered unless the two conditions above are met.

In the case of an advisor, the protection must come from a person to whom the advisor has provided any assistance or advice in respect of the avoidance transaction. In the case of a promoter, the protection must come from a person to whom the plan has been promoted or sold, who has received a representation that a tax benefit could result as part of the promotion or sale of the arrangement or who provided consideration to the promoter in respect of an arrangement.

The confidential protection hallmark will not be triggered if the confidentiality does not cover a "tax treatment" relating to an avoidance transaction. A "tax treatment" is a treatment in respect of a transaction, or series of transactions, that is used or is planned to be used in a tax return or tax information return (or would be used if such a return were filed) and includes a decision not to include a particular amount in such a return.

Confidential protection does not include the disclaiming or restricting of an advisor's liability if it does not prohibit disclosure of the details of the avoidance transaction.

The CRA Guidance further states that the following types of arrangements involving confidentiality do not give rise to a reporting requirement:

- protection of trade secrets that do not relate to tax
- standard confidentiality agreements that do not require tax advice to be confidential, such as a letter of intent that includes a confidentiality requirement
- standard commercial confidentiality provisions in standard client agreements or documentation, which do not contemplate a specific identified tax benefit or tax treatment

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### Contingent fee hallmark

The contingent fee hallmark is met where an advisor or promoter (or a person who does not deal at arm's length with the advisor or promoter) is entitled to a fee that is

- based on the amount of tax benefit that results from the avoidance transaction;
- contingent upon obtaining a tax benefit from the avoidance transaction; or
- attributable to the number of persons who participate in the avoidance transaction or have been given access to the advice or an opinion given by the advisor or promoter

Fees relating to preparing the prescribed form to claim scientific research and experimental development (SR&ED) tax credits are carved out from the contingent fee hallmark.

The CRA Guidance indicates that certain fees are not intended to be caught under the contingent fee hallmark, including

- certain standard fees collected by financial institutions in relation to the provision of an ordinary financial account that is broadly offered
- tax return preparation fees that result in tax refunds, including entitlement to personal tax credits
- fees based on the numbers of preparations/filings of income tax returns (even if they result in tax refunds) and income tax elections (including elections to defer tax)
- where the fee arrangements are made after the relevant transaction or series is completed, contingent litigation fees or fees for professional assistance provided to a taxpayer in relation to an audit, assessment or proposed reassessment
- standard fees of lawyers and accountants that are based solely on the value of services provided (based on factors such as the level of experience, time expended and degree of risk) without reference to the tax results





## Reporting requirements

### Series of transactions

The "series of transactions" concept has a prominent and impactful role in the reportable transaction (and notifiable transaction) rules. This concept is understood in case law as a set of transactions that are pre-ordained in order to achieve a specific outcome, with no real chance that the planned events would happen in a different order than planned.

A provision in the *Tax Act* expands on the series concept by providing that a series of transactions includes any "related" transactions that are completed "in contemplation" of that series. According to the courts, this includes transactions that happen because of or in relation to the series. In order for transactions to be added to an existing series under this statutory provision, the nexus does not have to be particularly strong: there only has to be a connection involving more than a mere possibility or an extreme degree of remoteness. Moreover, this statutory rule can be applied both looking forward and looking back in time. That is, an earlier transaction can be added to a later series, or a subsequent transaction can be added to an earlier series—provided, of course, that there is the requisite nexus between the transaction and the series in question.

The extended meaning of "series of transactions" can make it challenging to determine when a particular series begins or ends in some situations. This in turn can make it a challenge to determine the reportability of some transactions that are not integral, but are in some way related, to a reportable (or notifiable) transaction.

### Who has an obligation to report?

Assuming one has identified an avoidance transaction in relation to which at least one hallmark is present, then the transaction is a reportable transaction. The next step is to identify persons with an obligation to report.

Four categories of persons are required to file an information return in respect of a reportable transaction:

1. the person for whom a tax benefit results (or is expected to result) from the reportable transaction, from another reportable transaction that is part of the same series of transactions as the reportable transaction or from a series of transactions that includes the reportable transaction (see note above on series of transactions)
2. a person who has entered into an avoidance transaction that is a reportable transaction for the benefit of the person described above
3. an advisor or promoter (or a person not dealing at arm's length with an advisor or promoter) who is entitled to a fee that satisfies the contingency fee hallmark
4. an advisor or promoter (or a person not dealing at arm's length with an advisor or promoter) who is entitled to a fee for providing contractual protection

If it is reasonable to believe that information otherwise required to be reported is subject to solicitor-client privilege, then such information need not be disclosed by any person with a reporting obligation.

## An exemption for legal professionals?

Lawyers and other legal professionals are currently exempted from having to make filings in respect of reportable transactions and notifiable transactions. The Federation of Law Societies of Canada obtained an injunction pending the outcome of its challenge of the constitutionality of the application of these rules to legal professionals.

### Reporting deadline and prescribed form

Generally, the information return for the reportable transaction must be filed by each person with a reporting obligation with the CRA on or before the date that is 90 days after the earlier of

- the day the person became contractually obligated to enter into the reportable transaction
- the day on which the person entered into the reportable transaction

These rules apply to transactions that happen after June 22, 2023. Since a reportable transaction includes each transaction that is part of a series of transactions that includes the relevant avoidance transaction, reporting may be required for series of transactions that began on or before June 22, 2023. If a series of transactions includes a reportable transaction and spans the date when these rules became effective, reporting is required for the first reportable transaction that occurs after that date.

Reporting must be done in the prescribed manner using Form RC312, *Reportable Transaction and Notifiable Transaction Information Return*. Filing RC312 in respect of a reportable transaction is not an admission that the GAAR applies to any disclosed transaction or that such transaction is part of a series of transactions.





## Consequences of non-compliance with filing requirements

### Penalties

Where a person with a reporting obligation fails to file at all or on time, the person may become subject to penalties. Different penalties apply to persons with different roles in the transactions. In the case of a person described above in (1) or (2) under *Who has an obligation to report?*, the penalty is

- if the person is a corporation with assets that have a carrying value of $50 million or more, $2,000 per week for each failure to report, up to a maximum of the greater of $100,000 and 25% of the amount of the tax benefit
- in any other case, $500 per week for each failure to report, up to a maximum of the greater of $25,000 and 25% of the amount of tax benefit

In the case of an advisor or promoter (or any person who does not deal at arm's length with an advisor or promoter), the penalty is the total of the fees charged by that person in respect of the reportable transaction and an amount of up to $110,000.

The rules contain a due diligence defence: no penalty applies to a person who has exercised the degree of care, diligence and skill to prevent the failure to file that a reasonably prudent person would have exercised in comparable circumstances.

The CRA may make penalty assessments, determinations and redeterminations at any time for a person's failure to file an information return.

### Limitation period

Where a person does not file an information return in respect of a reportable transaction as and when required, the limitation period in respect of the relevant year of a taxpayer does not begin to run until the information return is filed.

Where a taxpayer has timely filed an information return but another person (for example, another party to the transaction or an advisor) has not complied with its separate requirement to make such a filing in respect of the same reportable transaction, it seems possible—as the rule is drafted—for the limitation period for the compliant taxpayer to be extended.

### Interaction with the GAAR

Where a person for whom a tax benefit results or is expected to result from the reportable transaction fails to report and has not fully paid any penalty or any interest on the penalty that the person is subject to for failing to report, section 245 of the *Tax Act*—the general anti-avoidance rule (GAAR)—is applied to the reportable transactions without the misuse or abuse test. As a result, until the penalty is paid, an unreported reportable transaction may trigger GAAR adjustments even if there was no misuse or abuse of the legislation.

Under proposed amendments, if a transaction has not been reported under the reportable transaction rules (including voluntarily, even if the transaction is not a reportable transaction) or the notifiable transaction rules

- the normal limitation period is extended by three years for GAAR assessments
- for a taxpayer that is successfully reassessed by the CRA under GAAR, a penalty will apply equal to 25% of the additional tax payable as a result of applying GAAR

These measures appear to be aimed at incentivizing disclosure where a taxpayer is concerned that the CRA may apply GAAR, even if the taxpayer believes GAAR should not apply and is not certain that the transaction is a reportable transaction (or notifiable transaction).

# Notifiable transaction rules

The new notifiable transaction rules in section 237.4 of the *Tax Act* require taxpayers and their advisors to notify the CRA if the taxpayer enters into transactions that are the same or substantially similar to those included on a list designated by the CRA, with the concurrence of the Minister of Finance.

The first list of notifiable transactions was published on November 1, 2023. The publication marks the beginning of potential disclosure obligations under the new rules. Although the legislative framework for the notifiable transaction rules received royal assent on June 22, 2023, the rules had no effect prior to the designation of any notifiable transactions.

## What is a notifiable transaction?

Under the legislation, a notifiable transaction is any transaction (or any transaction in a series) that is the same, or substantially similar to, a transaction (or series) that has been designated by the CRA or, if the CRA has designated a series, any transaction in a series that is the same as, or substantially similar to, the series designated by the CRA.

The term "substantially similar" is to be interpreted broadly in favour of disclosure, and includes a transaction or series in respect of which a person is expected to obtain the same or similar tax consequences and that is either factually similar or based on the same or a similar tax strategy as a transaction or series designated by the CRA.

At a very high level, the current list of notifiable transactions has five categories:

1. straddle loss creation transactions using a partnership
2. avoidance of deemed disposition of trust property
3. manipulation of bankrupt status to reduce a forgiven amount in respect of a commercial obligation
4. reliance on purpose tests in section 256.1 to avoid a deemed acquisition of control
5. back-to-back arrangements intended to circumvent the thin capitalization rules and Part XIII withholding tax

A specific description of each of these categories is provided below and the up-to-date list is available on this CRA website.

For each of the designated transactions, the list published by the CRA includes two sections: an introduction, which sets out general information about and the rationale for including the relevant transactions in the list, and a "designated transactions" section that formally identifies the designated series of transactions and provides the effective date.

### Straddle loss creation transactions using a partnership

The CRA has observed that some taxpayers have been using partnerships and derivatives in an attempt to circumvent the application of the specific anti-avoidance rules related to straddle transactions that were introduced in the 2017 Federal Budget and are contained in subsections 18(17) to (23) of the *Tax Act*.

Accordingly, the following series of transactions is designated:

1. A taxpayer enters into an agreement to acquire a partnership interest from an existing partner.
2. The partnership trades foreign exchange forward purchase and sale agreements on margin through a foreign exchange trading account. The foreign exchange forward agreements are essentially straddle transactions where it is reasonable to conclude that each agreement is held in connection with the other and where, in the aggregate, the individual agreements (legs) will generate substantially equal and offsetting gains and losses.
3. Shortly before the taxpayer's acquisition of the interest in the partnership, the partnership disposes of the gain leg(s) of the foreign exchange forward agreement(s).
4. The income from the gain leg(s) is then reflected in the income of the partnership and is allocated to the original partner immediately prior to the acquisition of the interest in the partnership by the taxpayer.
5. Following the acquisition of the partnership interest by the taxpayer, the loss leg(s) are realized and a business loss is allocated to the taxpayer.





### Avoidance of deemed disposition of trust property

Most trusts are subject to a deemed realization rule every 21 years: capital property of trusts is deemed to have been disposed of and reacquired at fair market value every 21 years. Various rules seek to prevent deferral past the 21 years, including by transferring the property to another trust, to a capital beneficiary or to a non-resident beneficiary.

In response to various transactions entered into by taxpayers to avoid or defer the 21-year deemed realization rule, the CRA designated three types of series:

1. **Indirect property transfers to another trust:** prior to its 21-year anniversary, Trust A transfers property to a Canadian corporate beneficiary, the shares of which are held by Trust B.
2. **Indirect property transfers to a non-resident:** prior to its 21-year anniversary, a trust transfers property to a Canadian corporate beneficiary, the shares of which are held by a non-resident beneficiary of the trust.
3. **Transfers of trust value by means of deemed dividend as follows:**
   - Trust A owns shares in an Opco.
   - Prior to Trust A's 21-year anniversary, Opco redeems those shares in exchange for a promissory note or cash, resulting in a dividend deemed to be paid to Trust A.
   - Trust A designates that deemed dividend as being receivable by a Canadian corporate beneficiary, Holdco, the shares of which are held by Trust B.
   - Trust A also provides the promissory note or cash to Holdco.
   - Holdco deducts the deemed dividend under subsection 112(1).

### Manipulation of bankrupt status to reduce a forgiven amount in respect of a commercial obligation

Debt forgiveness rules provide that where a commercial debt obligation is settled or extinguished for less than its principal or issuance amount, the "forgiven amount" applies to reduce various tax attributes or potentially result in an income inclusion. The forgiven amount is reduced by the principal amount of the obligation if the debtor is bankrupt at the time of the settlement.

The CRA explains that some taxpayers temporarily enter into bankruptcy, settle commercial debt obligations and then reverse their bankruptcy, having reduced the forgiven amount to nil without any reduction in tax attributes or income inclusion.

Accordingly, the following series of transactions is designated:

1. A person or partnership (Debtor) is placed into bankruptcy.
2. A commercial obligation of the bankrupt Debtor is settled, deemed to be settled or extinguished for an amount that is less than the principal amount of the obligation.
3. The Debtor takes steps to annul the bankruptcy status through the judicial process.

### Reliance on purpose tests in section 256.1 to avoid a deemed acquisition of control

Various deeming provisions apply in respect of the acquisition of control rules, which impact the use of corporate tax attributes. Some of the deeming provisions refer to situations where one of the main reasons of a person or group of persons is either to acquire or to avoid acquiring control of a corporation. The CRA states that some taxpayers have relied on these purpose tests to avoid the application of the relevant deeming rules on acquisition of control.

As a result, the CRA designated three types of series in respect of three provisions with purposes tests: paragraph 256.1(2)(d), paragraph 256.1(4)(a) and subsection 256.1(6).

1. Purpose test in paragraph 256.1(2)(d):
   - Lossco is a taxable Canadian corporation that has some tax attributes, the use of which is restricted under section 256.1 and certain other provisions as envisaged in the definition "attribute trading restriction" in subsection 256.1(1).
   - Aco does not hold shares of Lossco with a fair market value (FMV) that satisfies the 75% FMV threshold test.
   - At a particular time, Aco acquires shares of Lossco resulting in the satisfaction of the 75% FMV threshold test, but without acquiring control over Lossco, and the taxpayer takes the position that since the purpose test in paragraph 256.1(2)(d) is not met, subsection 256.1(3) does not apply.

2. Purpose test in paragraph 256.1(4)(a):
   - Lossco is a taxable Canadian corporation that has some tax attributes, the use of which is restricted under section 256.1 and certain other provisions as envisaged in the definition of "attribute trading restriction" in subsection 256.1(1).
   - Profitco and Aco (which does not deal at arm's length with Profitco) acquire shares of Lossco.
   - Following the acquisition, Profitco does not control Lossco and does not hold shares of Lossco with a FMV that satisfies the 75% FMV threshold test, but it would satisfy the 75% FMV threshold test if the Lossco shareholding by non-arm's length Aco is disregarded.
   - The taxpayer takes the position that subsection 256.1(3) does not apply since the purpose test in paragraph 256.1(4)(a) is not met.

- Purpose test in subsection 256.1(6):
- Lossco is a taxable Canadian corporation that has some tax attributes, the use of which is restricted under section 256.1 and certain other provisions as envisaged in the definition of "attribute trading restriction" in subsection 256.1(1).
- Lossco acquires control of Profitco.
- It can reasonably be concluded that one of the reasons for the acquisition of control is so that a specified provision as defined in subsection 256.1(1) does not apply.
- However, the taxpayers take the position that subsection 256.1(6) does not apply since the purpose test is not met.

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## Back-to-back arrangements

Canada's thin capitalization rules deny a deduction (or require an income inclusion) for certain interest paid or payable to certain non-residents. Specific rules address back-to-back arrangements where intermediaries are used to avoid the thin capitalization rules, while similar rules address the use of back-to-back arrangements in the withholding tax context.

The CRA designated the following series in respect of certain financing and other arrangements structured through intermediaries:

1. **Thin capitalization:** Canco would be subject to the thin capitalization rules for interest paid to Forco1 ("Forco" denoting a non-resident corporation), but Forco1 enters into an arrangement with arm's length Forco2 to indirectly provide financing to Canco and the latter takes the position that the interest paid is not subject to the thin capitalization rules.
2. **Withholding tax:** Canco makes a payment (such as of interest, rents or royalties) to Forco2 that would have been subject to withholding tax had it been paid to Forco1 and takes the position that the payment is not subject to withholding tax (or benefits from a lower rate than would have applied had the amount been paid to Forco1).

## Who must report a notifiable transaction?

If a notifiable transaction takes place, reporting of the transaction is required by all of the following persons:

### A. Participants in the transaction

- any person who obtains or is expected to obtain a tax benefit from the notifiable transaction, another notifiable transaction in the same series, or from the series itself
- every person who entered into the notifiable transaction for the benefit of the person who obtains or is expected to obtain the tax benefit

### B. Advisors and promoters

- every advisor or promoter in respect of the notifiable transaction
- every person not dealing at arm's length with an advisor or promoter in respect of the notifiable transaction and who was entitled to a fee in respect of the transaction (including contingent fees)

An **advisor** is any person who provides assistance or advice with respect to creating, developing, planning, organizing or implementing the notifiable transaction.

A **promoter**, in respect of a transaction or series, has the same definition as for the reportable transaction rules, the full details of which are set out in that section above. Generally, this includes any person who promotes or sells an arrangement, plan or scheme that includes or relates to the transaction or series, or who accepts consideration in respect of such arrangement, plan or scheme.

A person who only provides **clerical or secretarial** services in respect of the notifiable transaction is not required to report.

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Unlike the reportable transaction rules, the reporting obligation for notifiable transactions is the same for all of the above-listed persons and does not depend on whether the advisors or promoters receive a fee. However, a reporting obligation exemption applies where an advisor or promoter (plus those not dealing at arm's length with them) does not know and should not reasonably be expected to know that the transaction was a notifiable transaction.

Finally, a separate due diligence defense is available to participants in the transaction that 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. This standard has been applied in other contexts, and generally requires the person to have taken active steps to ensure compliance. The determination of whether the standard is met is fact-specific.

The scope of the due diligence and reasonable to know defences is uncertain, and is likely to remain uncertain until the courts are able to provide guidance. For example, there is no explanation regarding how the defences might apply to organizations (including corporations and partnerships). They do not specify whether the tests apply to the organization as a whole, aggregating all their collective knowledge even if in practice that knowledge was not shared, or whether the tests apply to individual members of the organization.

## When is reporting required?

The deadline to report a notifiable transaction is generally 90 days after the earliest of the date that a participant in the transaction became contractually obligated to enter into the transaction and the date on which the transaction was entered into. For a series of transactions that only gets designated after the first transaction in the series has been agreed to or completed, the determination of the deadline date should have regard to the fact that the transaction was not a "notifiable transaction" at that earlier time.

## What must be reported about a notifiable transaction?

Reporting is required by way of an information return in prescribed form. Form RC312 has been prescribed for both notifiable and reportable transactions. Filing RC312 in respect of a notifiable transaction is not an admission that any transaction is part of a series of transactions.

In respect of a notifiable transaction, the required information includes

- the identity of the person required to disclose and whether the person obtained the tax benefit, entered into the transaction for the benefit of the person obtaining the tax benefit or is an advisor or promoter in respect of the transaction
- the identity of the person obtaining the tax benefit, if different from the person required to disclose
- identification of which transaction designated by the CRA in relation to which the notifiable transaction is the same or substantially similar
- the date the transaction is required to be disclosed
- whether recurring tax benefits are anticipated and in which years the tax benefit is expected to be used
- whether the transaction is the same as the transaction designated by the CRA, or whether it is substantially similar to the designated transaction
- a description of the reason the notifiable transaction is being disclosed

If the notifiable transaction is also a reportable transaction, required information in respect of reportable transactions must also be reported about the same transaction.

Similar to reportable transactions, subsection 237.4(18) explicitly recognizes that information protected by solicitor-client privilege does not need to be reported under the notifiable transaction rules.



## What are the consequences of late reporting or a failure to report?

A person who fails to file an information return in respect of a notifiable transaction as and when required is liable to a penalty equal to those imposed in respect of reportable transactions.

### A. Participants in the transaction

In the case of participants in the transaction, if the person is a corporation with assets that have a carrying value of $50 million or more, the penalty is $2,000 per week the failure continues, up to a maximum of the greater of $100,000 and 25% of the tax benefit.

For all other participants in the transaction, the penalty is $500 per week the failure to report continues, up to a maximum of the greater of $25,000 and 25% of the tax benefit in relation to the notifiable transaction.

### B. Advisors and promoters

For advisors and promoters, as well as persons not dealing at arm's length who are entitled to a fee in respect of the notifiable transaction and are required to report, the penalty for failure to report on or before the deadline is equal to the total of

- the amount of fees charged by that person in respect of the notifiable transaction
- $10,000
- $1,000 per day the failure continues up to a maximum of $100,000

There is no time limit for the CRA to assess a penalty against a person for failure to report a notifiable transaction.

In addition, the CRA may reassess a taxpayer at any time beyond the normal reassessment period in relation to a notifiable transaction if the notifiable transaction has not been reported as required. If the notifiable transaction is reported late, the reassessment period is extended to three years after the notifiable transaction is reported (or four years in the case of a mutual fund trust or a corporation that is not a Canadian-controlled private corporation (CCPC)).

## Implications and takeaways

The two key challenges for the notifiable transaction rules are clarifying the scope of (1) the meaning of "substantially similar" and (2) the due diligence and reasonable to know defences. Understanding the former concept is critical for knowing when a reporting obligation may arise. The scope of the due diligence and reasonable to know defences is uncertain, and is likely to remain uncertain until the courts are able to provide guidance. For example, there is no explanation regarding how the defences might apply to organizations (including corporations and partnerships). Do the tests apply to the organization as a whole, aggregating all their collective knowledge even if in practice that knowledge was not shared, or would the tests apply to individual members of the organization?

# Reportable uncertain tax treatment rules

Generally speaking, an uncertain tax treatment is a tax treatment used, or planned to be used, in a corporation's income tax filings for which there is uncertainty over whether the tax treatment will be accepted as being in accordance with tax law. Corporations that use International Financial Reporting Standards (IFRS) or U.S. generally accepted accounting principles (GAAP) are required to identify uncertain tax treatments for financial statement purposes (pursuant to IFRIC 23 for IFRS and FIN 48 (codified in ASC 740) for U.S. GAAP). The new reportable uncertain tax treatment (RUTT) rules in section 237.5 of the *Tax Act* require certain corporations that are subject to these accounting rules to disclose each RUTT to the CRA on an annual basis.

The new RUTT rules apply to taxation years that begin after 2022. They require a "reporting corporation" that has one or more "reportable uncertain tax treatments" for a taxation year to file an information return disclosing each RUTT on or before its filing due date for the year. The meaning of "reporting corporation" and "reportable uncertain tax treatments" is discussed below. These concepts play a crucial role in determining whether a taxpayer is required to report under the RUTT rules.

The CRA Guidance provides a number of clarifications and details regarding the CRA's administrative approach to the reporting obligations under the RUTT rules. The CRA Guidance is also discussed below.

## Who is required to report under the RUTT rules?

The RUTT rules apply to a "reporting corporation", defined as a corporation where all of the following apply:

(a) The corporation, or a consolidated group of which it is a member, has prepared "relevant financial statements". The "relevant financial statements" of a corporation are, generally, audited financial statements for the corporation or its consolidated group prepared in accordance with IFRS or certain other country-specific GAAP relevant for public corporations that are listed on a stock exchange outside Canada, such as U.S. GAAP.

(b) The corporation has at least $50 million in assets at the end of the taxation year. The carrying value of the corporation's assets is determined in accordance with paragraphs 181(3)(a) and (b) of the *Tax Act*, which establishes specific rules for determining the "carrying value" of a corporation's assets or any amount under Part I.3 (tax on large corporations). The CRA Guidance confirms that this asset threshold is applied on an entity-by-entity basis.

(c) The corporation is required to file a Canadian tax return under section 150.

## What is a RUTT?

A "reportable uncertain tax treatment" or "RUTT" is a tax treatment that a corporation either uses or plans to use in an income tax return or information return in respect of which uncertainty is reflected in the relevant financial statements of the corporation (or its consolidated group) for the year.

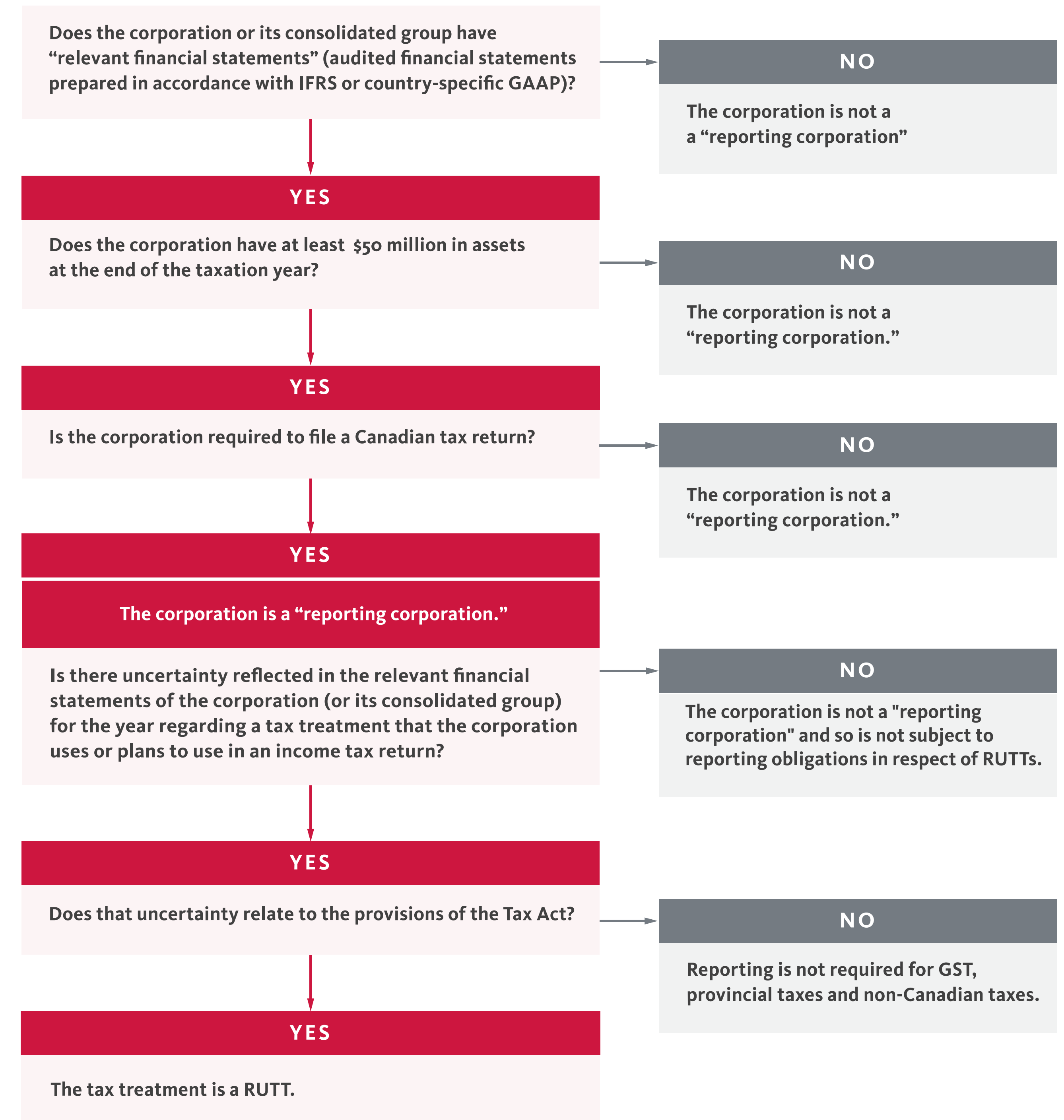
While the definition of "reportable uncertain tax treatment" in subsection 237.5(1) refers to tax generally, the CRA has confirmed that only uncertain tax treatments relating to provisions of the Act need to be reported. Thus, the reporting obligation does not extend to HST/GST, provincial taxes and non-Canadian taxes. This scope is also reflected by the prescribed reporting form RC3133, which requires a description of the provisions relied upon for determining the tax payable under the *Tax Act*, or the refund or other amount under the *Tax Act*, the Income Tax Regulations, Income Tax Application Rules, a Treaty or any other enactment that is relevant in computing tax or any other amount payable or refundable under the *Tax Act*.

The definition of "tax treatment" in subsection 237.5(1) is broad and includes a decision not to include a particular amount in a return.

## Checklist for reporting obligation

- ☐ Does the corporation or its consolidated group have "relevant financial statements" (audited financial statements prepared in accordance with IFRS or country-specific GAAP)? If no, then the corporation is not a "reporting corporation."
- ☐ Does the corporation have at least $50 million in assets at the end of the taxation year? If no, then the corporation is not a "reporting corporation."
- ☐ Is the corporation required to file a Canadian tax return? If no, then the corporation is not a "reporting corporation."
- ☐ Is there uncertainty reflected in the relevant financial statements of the corporation (or its consolidated group) for the year regarding a tax treatment that the corporation uses or plans to use in an income tax return? If not, there is not a RUTT.
- ☐ Does that uncertainty relate to the provisions of the *Tax Act*? If not, there is not a RUTT.

FIGURE 2
## FLOWCHART FOR REPORTING OBLIGATION



## Reporting mechanics

RUTTs are required to be reported at the same time that the reporting corporation's Canadian income tax return is due. The prescribed form is RC3133, the Reportable Uncertain Tax Treatments Information Return. This form must be filed on an annual basis, even for recurring RUTTs. The disclosure requirements for events already known to the CRA can be satisfied by referencing and attaching previously filed documents (e.g., notices of objection, previously filed RC312 or RC3133 forms). The CRA Guidance indicates that if a RUTT is reversed in the financial statements, it does not need to be reported in the year of the reversal.

The CRA Guidance indicates that reporting corporations need to disclose RUTTs in respect of their partnership interests.

For each RUTT, the reporting corporation is required to disclose the taxation year to which the RUTT pertains, a description of the relevant facts and the tax treatment, the provisions relied upon, the amount of taxes at issue and whether the uncertainty relates to a permanent or temporary difference.

The CRA Guidance confirms that RUTT reporting must be done on an entity-by-entity basis, and not on a consolidated basis, even if the "relevant financial statements" reflecting the RUTT are consolidated financial statements. The CRA Guidance also indicates that reporting must be in Canadian dollars, even if the relevant financial statements are in another currency and the taxpayer has filed a functional currency election. If the financial statements are in another currency, the reporting corporation must convert the RUTT amount to Canadian dollars.

Filing an information return is not an admission that the GAAR applies to any disclosed transaction or that such transaction is part of a series of transactions.

### What are the consequences of late reporting or a failure to report?

There are significant penalties and extended reassessment periods associated with failure to report a RUTT:

- The penalty is $2,000 per week for each RUTT up to a maximum of $100,000 per RUTT. However, the penalty for failing to report does not apply to taxation years that begin before royal assent on June 22, 2023.
- The normal reassessment period in respect of an uncertain tax position does not begin until the RUTT is reported.

There is a due diligence defence if the reporting corporation can demonstrate it exercised the degree of care, diligence and skill to prevent the failure to report a RUTT.





## An exemption for legal professionals?

Lawyers and other legal professionals are currently exempted from the application of the mandatory disclosure rules, including in respect of notifiable transactions. The Federation of Law Societies of Canada obtained a temporary injunction pending the outcome of its application for an injunction. The hearing for the application was held on October 20, 2023. The temporary injunction will apply until the earlier of December 1, 2023, and the date on which the court releases its decision in response to the application. It is possible that the court would further extend the deadline. The injunction relates to the challenge brought by the Federation of Law Societies of Canada as to the constitutionality of the mandatory disclosure rules now in force.

Lawyers and other legal professionals should closely monitor the battle of the Federation of Law Societies of Canada in the British Columbia Supreme Court and the court verdict on the application of the mandatory disclosure rules to them.

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If you have any questions, require additional analysis of Canada's mandatory disclosure rules or would like assistance with navigating the rules, please contact any member of our National Tax Group.

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