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Canadian mandatory disclosure rules update: implementing bill and explanatory notes

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Budget Implementation Act, 2023, No. 1, which includes the Canadian income tax mandatory disclosure rules, was introduced in Parliament on April 20, 2023 as Bill C-47. First announced in Budget 2021, the mandatory disclosure rules expand the existing reportable transaction rules and introduce new reporting obligations in respect of "notifiable transactions" and "reportable uncertain tax treatments". Failure to comply with the new rules results in an extension of the normal reassessment period and can result in significant penalties.

Compared to the draft legislation released on August 9, 2022, Bill C-47 makes significant changes to the reportable and notifiable transaction rules. These changes are set out below. For full details about the prior drafts of the mandatory disclosure rules, please see our Osler Updates summarizing the February 4, 2022 and the August 9, 2022 drafts.

Reportable transaction rules

The reportable transaction rules require detailed reporting by taxpayers, promoters and advisors of transactions that bear hallmarks the government views as being indicative of tax-motivated transactions. Currently, transactions are reportable to the Canada Revenue Agency (CRA) if they are "avoidance transactions" (within the meaning of the general anti-avoidance rule) and bear at least two of three generic hallmarks relating to contingent fees, confidential protection and contractual protection. The revised reportable transaction rules use an expanded definition of "avoidance transaction", only require that one of the three hallmarks be present for the transaction or series to be reportable, make a number of changes to the hallmarks and significantly increase penalties and other adverse consequences for failure to report. This reporting is required by each relevant party; reporting by one party does not discharge the reporting obligations of other parties.

A threshold condition for there to be a reportable transaction is that there be an "avoidance transaction", which Bill C-47 — unchanged from the August 9, 2022 draft legislation — reorients around a "one of the main purposes" test. Specifically, an avoidance transaction is now defined as a transaction if it may reasonably be considered that one of the main purposes of the transaction, or of a series of transactions of which the transaction is a part, is to obtain a tax benefit. Obtaining the tax benefit need not be abusive in order for a transaction to satisfy the definition.

As compared to the August 9, 2022 draft legislation, the revised rules in Bill C-47 reflect important changes to the contractual protection hallmark, the deadline for filing the required information report, penalties and the provision concerning solicitor-client privilege. The explanatory notes include new information about the contingent fee hallmark that reflect submissions from Osler and others received by the government during the publication

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consultation periods for prior drafts.

The contractual protection hallmark is revised to address concerns about its potential unintended application to arm's length M&A transactions where tax indemnities are part of the business purchase arrangements. Specifically, in addition to the existing exemption for standard professional liability insurance, the definition of "contractual protection" now 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, and
- obtained primarily for purposes other than to achieve any tax benefit from the transaction or series.

This new carve-out for indemnities and insurance in M&A transactions (together with the accompanying explanatory notes) narrows the wording in the August 9, 2022 draft legislation, which raised concerns that most ordinary M&A transactions may have become reportable. The above carve-out, according to the explanatory notes, is meant to apply to standard representations, warranties and guarantees between arm's length vendors and purchasers, alongside customary representation and warranty insurance policies, obtained in the ordinary commercial context of mergers and acquisitions to safeguard purchasers from pre-closing obligations, such as tax liabilities. Such safeguards should generally prevent the contractual protection hallmark from being satisfied.

However, the explanatory notes add that this exception would not apply to other forms of insurance or protections acquired to cover identified tax risks, such as tax liability insurance policies in relation to avoidance transactions.

Bill C-47 and the explanatory notes also provide some clarification that narrows the scope of the contingent fee hallmark. That hallmark is present when an advisor or promoter is entitled to certain types of fees relating to the quantum or achievement of tax benefits from, or the number of participants in or recipients of advice about, an avoidance transaction or series.

Bill C-47 amends the contingent fee hallmark to carve out fees for preparing scientific research and experimental development (SR&ED) claims even if they are contingent on the tax benefits resulting from the claims.

Although Bill C-47 does not include any further amendments to the contingent fee hallmark, the explanatory notes clarify that the following types of fee arrangements are generally out of scope:

- For advisors: "value billing" and tax litigation contingent fees.
- For financial institutions: collection of standard fees:
    - for the establishment and ongoing administration of a financial account (e.g. RRSP) or a financial instrument (e.g. segregated fund) even if the fee is determined in relation to the investment amount,
    - where the fee offered to a particular client is discounted in relation to the number of financial accounts maintained by the financial institution for the particular client, and
    - as a normal per-transaction charge for each security trade in the context of a year-end tax-loss selling program operated by the financial institution.

Bill C-47 provides for a deadline for filing an information return disclosing reportable

transactions of 90 days after the earliest day on which a relevant person is either contractually obligated to enter into, or actually enters into, the reportable transaction. This is in contrast to the August 9, 2022 proposals, which provided for a deadline of only 45 days after the applicable triggering event.

Currently, all persons liable for a penalty in respect of a reportable transaction are jointly and severally liable. Bill C-47 eliminates such joint and several liability. No change was made to the relieving provision that 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.

The solicitor-client privilege exemption, which applies "for greater certainty", currently provides that lawyers acting as advisors for a reportable transaction are not required to disclose information that is subject to solicitor-client privilege. That exemption is revised to provide generally that information need not be disclosed (whether by a lawyer or non-lawyer) where it is reasonable to believe that this information is subject to solicitor-client privilege.

As indicated in the 2022 Fall Economic Statement, the amended rules are set to apply to reportable transactions that are entered into after the date when Bill C-47 receives royal assent. However, this does not mean that all transactions entered into prior to that date will be exempt from reporting. The series of transactions concept plays a prominent role in the reportable transaction rules. A reportable transaction includes not only an avoidance transaction, but each transaction that is part of a series of transactions that includes the avoidance transaction. Series of transactions that straddle the date of royal assent may give rise to reporting obligations even if the relevant avoidance transaction occurs before royal assent.

Reportable transactions are required to be disclosed to the CRA in prescribed form, manner and timing. Failure to comply with the reporting obligation on a timely basis can give rise to a significant penalty that, in certain situations, can be as high as 25% of the amount of the relevant tax benefit.

Notifiable transaction and reportable uncertain tax treatments rules

Bill C-47 also introduces new mandatory disclosure requirements in respect of "notifiable transactions" and "reportable uncertain tax treatments" that were proposed in the legislative proposals released on February 4, 2022 and August 9, 2022. These requirements are subject to significant penalties similar to those for reportable transactions.

The new notifiable transaction rules are meant to address specific types of transactions of interest to the government as designated by the Minister of National Revenue with the concurrence of the Minister of Finance. In 2022, the government released an indicative list of transactions (or series of transactions) that could potentially be designated as notifiable transactions. All transactions or series that are "substantially similar" to a designated transaction or series will also fall within the ambit of a notifiable transaction. (Further details on the indicative list of transactions are included in our Osler Update summarizing the February 4, 2022 draft).

The "due diligence" defence for notifiable transactions has been significantly revised compared to the August 2022 draft. It previously provided protection against the imposition of a penalty for any person required to report a notifiable transaction. This defence has now been removed entirely in respect of penalties. However, persons who obtain or expect to obtain a tax benefit from a notifiable transaction, and persons who enter into such

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transactions for the benefit of such a person, will not have to file an information return if they have exercised the degree of care, diligence and skill in determining whether the particular transaction is a notifiable transaction that a reasonably prudent person would have exercised in comparable circumstances. The explanatory notes say that such persons can exercise the required level of diligence by asking their advisors about reporting requirements that may stem from a transaction. If their advisors inform them that no such reporting duties exist, they will have met their due diligence obligations.

The previous exemption for banks, insurance corporations and credit unions acting as advisors or promoters (unless they would “reasonably be expected to know” the transaction was notifiable) is now removed. Instead, any person acting as an advisor or promoter is not required to file an information return unless they should “reasonably be expected to know” the transaction was notifiable.

While the rules for all three parts of the mandatory disclosure rules include relieving provisions that filing an information return does not constitute an admission, the relieving provision for notifiable transactions is the narrowest. The notifiable transaction rules provide that filing an information return does not constitute an admission that any transaction is part of a series.The reportable transaction and reportable uncertain tax treatment rules additionally provide that filing an information return is not an admission that the GAAR applies or that the tax treatment is inconsistent with the ITA or its regulations.

Several of the changes made for reportable transactions compared to the August 9, 2022 draft legislation are similarly made for notifiable transactions, namely: removing the joint and several liability provision; revising the solicitor-client privilege exemption; extending the deadline for reporting obligations from 45 days to 90 days; and confirming that the new rules will come into force on royal assent.

Finally, no significant changes were made to the “reportable uncertain tax treatment” legislation or explanatory notes compared to those released on August 9, 2022. These rules will apply to taxation years that begin after 2022, except that the penalty provision does not apply to taxation years that begin before the date on which Bill C-47 receives royal assent.