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CRA revises and expands its guidance on mandatory disclosure rules

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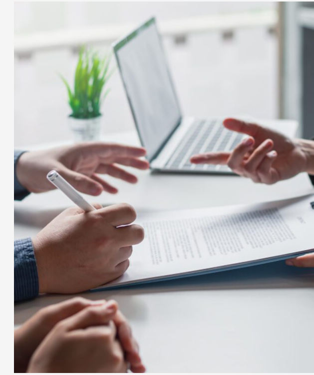

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On November 2, 2023, the Canada Revenue Agency (CRA) revised and expanded its guidance on the Canadian mandatory disclosure rules (Guidance). The updated Guidance includes important revisions of previously published positions and new positions relating to the reporting obligations in respect of reportable transactions, notifiable transactions and reportable uncertain tax treatments.

Reportable transactions

Confidential protection

The Guidance already provided that measures protecting trade secrets that do not relate to tax do not give rise to a reporting obligation. The updated Guidance additionally states that a confidential hallmark is not met and a reporting requirement is not triggered by the following types of agreements:

- standard confidentiality agreements that do not require tax advice to be confidential
- standard commercial confidentiality provisions in standard client agreements or documentation that do not target a specific identified tax benefit or tax treatment

The Guidance provides as an example of the first of these two categories a letter of intent that includes a confidentiality requirement. Since letters of intent typically deal with a range of matters, the carve-out for "standard confidentiality agreements" apparently includes standard confidentiality provisions in contracts dealing with a range of matters, not just confidentiality obligations. This category would thus appear to apply broadly to many standard confidentiality provisions that do not specify that tax advice must be kept confidential.

In the second category, where the contract is with a "client", such as a client of an advisor, the confidentiality protection hallmark would not be met as long as the confidentiality provisions do not target a specific identified tax benefit or tax treatment. Comparing the two new categories, it is unclear (a) why there are two — one for "confidentiality agreements" (which as noted can include confidentiality provisions) and one for "confidentiality provisions in ...

client agreements or documentation”; (b) why the two categories require non-confidentiality of different subject matter — namely, “tax advice” for the former and “a specific identified tax benefit or tax treatment” for the latter; and (c) whether there is intended to be any overlap in scope of the two categories. The Guidance does not provide further details in this regard, nor does it explain how one is to determine whether a provision or agreement is “standard”.

Contractual protection

The revised Guidance makes some changes to the prior commentary on the statutory carve-out from contractual protection for tax insurance, indemnities or other protection that is integral to an agreement between arm’s length persons in respect of the sale of all or part of a business (the M&A Carve-out). The changes include

- contractual protection obtained by a purchaser in connection with an acquisition structured to achieve a paragraph 88(1)(d) bump of non-depreciable capital property of the target company (previously only applicable where the acquiror is a public company, this carve-out is now extended to potentially apply to private corporations)
- protection against subsection 116(5) liability in respect of dispositions of taxable Canadian property by a non-resident of Canada without obtaining a section 116 certificate of compliance (previously only applicable to tax insurance, this carve-out is now extended to other forms of contractual protection in this situation)
- a new carve-out for indemnities or covenants obtained by a purchaser or target in respect of Part III tax liabilities and other tax consequences arising from dividend payments made as part of a pre-closing reorganization
- a new example added regarding a merger or acquisition effected by the amalgamation of two arm’s length corporations (including in connection with a standard amalgamation squeeze-out transaction)

The Guidance adds to the list of indemnities, insurance or other protection that may not fit the M&A Carve-out but that the CRA will not treat as contractual protection giving rise to a reporting obligation:

- standard commercial indemnity provisions in standard client agreements or documents that do not target specific identified tax benefits or tax treatment
- standard contractual representations and indemnities in an arm's length situation with respect to the failure to deduct or withhold Part XIII tax
- other types of price adjustment clauses, such as working capital adjustment clauses in sale and purchase arrangements, that are not “tax-driven” (previously only carved out “standard” price adjustment clauses)
- a general carve-out for protection provided in a normal commercial or investment context in which arm's length parties act prudently, knowledgeably and willingly where the protection does not extend to a tax treatment in respect of an avoidance transaction. The Guidance previously carved out certain indemnities for RRSP trustees. The RRSP carve-out

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is now one of three non-exhaustive examples for the new, general category. The other two examples are new:

1. tax indemnities in standard provisions (e.g., gross-up clauses) in loan agreements or International Swap and Derivative Association agreements
2. tax indemnities in employment agreements and severance agreements

- "tax return insurance", an undefined term that may refer to insurance that provides general coverage against expenses arising from an audit or dispute relating to a tax return and/or additional taxes imposed as a result of a successful adverse adjustment to tax positions reflected on a tax return. The Guidance states that such insurance will not be contractual protection provided the insurance applies to the taxpayer's filings generally and not to a particular transaction or series of transactions resulting from "aggressive tax planning". In what appears to be an explanation of why this insurance product should not be reportable, the Guidance notes that such insurance would not pay for or reimburse taxpayers for taxes assessed in respect of aggressive tax planning and that the maximum insurance coverage (or protection) would likely not cover a material portion of the taxpayer's expenses incurred as a result of an audit in respect of aggressive tax planning.
- re-insurance of a risk where the original insurance policy is not subject to a reporting obligation
- a standard clause in a partnership agreement providing that, in the event of an audit of a partner, the partnership will provide the partner with reasonable assistance to help them resolve the audit, unless the "purpose of the clause contemplates any particular avoidance transaction or series of transactions (including an avoidance transaction)"
- in the context of a tax-deferred mutual fund merger pursuant to section 132.2, an indemnity in the merger agreement provided by the fund manager to the trustee of the terminating fund for any liabilities that might arise in respect of the terminating fund

Contingent fees

The contingent fee hallmark involves situations where an advisor or promoter is entitled to a contingent fee that is based on the amount of a tax benefit resulting from the transaction, success in obtaining the tax benefit, or the number of persons participating in the transaction. The Guidance makes one notable change in connection with this hallmark. The carve-out for contingent litigation fee arrangements relating to appeals of tax assessments in respect of tax benefits arising from completed transactions or series now generally applies to contingent fees for all professional assistance provided in connection with tax audits and (re)assessments (previously only applicable to lawyers).

Notifiable transactions

The Guidance adds new information about series of transactions that include transactions occurring both before and on or after the effective date of when notifiable transactions are designated. The CRA explains that where a person enters into a series of transactions that

straddle the effective date of such a series (or one that is substantially similar) being designated, the reporting requirement is triggered with the first transaction in the series entered into after the designation date.

Reportable uncertain tax treatments

The Guidance now provides that reporting obligations in respect of reportable uncertain tax treatments do not apply to portfolio investments by corporations in private equity limited partnerships or publicly traded partnerships. The CRA's stated rationale for this carve-out is that each investor's contribution to such a partnership is usually small relative to the overall amount of capital invested; investors generally do not control managers or general partners of such partnerships; and investors face practical difficulties in obtaining relevant information.

Takeaways

The CRA's willingness to further revise its Guidance on reportable transactions is welcome, particularly in respect of normal commercial and investment arrangements, such as gross-ups in credit agreements or ISDA documents, or standard confidentiality provisions in a variety of commercial agreements. Moreover, while some of the borderlands of the M&A Carve-out remain undefined, the Guidance brings more kinds of tax protections provided in sale and purchase transactions into the ambit of the non-reportable.

The Guidance still leaves much room for debate and judgment in applying the mandatory disclosure rules. Many of the carve-outs or examples of non-reportable transactions are caveated by mention that the relevant exemption from reporting may not apply if certain provisions or agreements are not “standard” or if there is “aggressive tax planning”. Such terms, which are undefined and have an unclear scope, cast some doubt on the range of situations in which the business community may rely upon this guidance.