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Via Email : consultation-legislation@fin.gc.ca

Dear Sirs/Mesdames:

RE: Submissions of Osler, Hoskin & Harcourt LLP on the February 4, 2022 Draft Legislation ("Draft Legislation") Pertaining to Reportable Uncertain Tax Treatments

We appreciate the opportunity to provide comments on the proposed disclosure and reporting of a "reportable uncertain tax treatment" as defined in the Draft Legislation. In general, these rules require a "reporting corporation" with assets of a total carrying value of at least $50 million at the end of the year to file an information return disclosing such reportable uncertain tax treatments on or before its filing due date for the year.

The stated purpose of these rules as set out in the Backgrounder is to enhance the ability of the Canada Revenue Agency ("**CRA**") to "respond quickly to tax risks". We note that this measure does not form part of the recommendations in the OECD Mandatory Disclosure Rules, Action 12 Final Report. However, Budget 2021 stated that these proposed rules are intended to align Canada's tax reporting with other jurisdictions that have enacted similar legislation, namely the United States, Australia, and the United Kingdom.

These submissions are not intended to comment on the policy choice to enact uncertain tax treatment reporting. Rather, our specific concerns relate to the level of detail required from the taxpayer — which appears to be more extensive than that required by other jurisdictions. Our concern is that the level of detail essentially requires a taxpayer to self-audit and undermines the taxpayer's right to maintain any applicable privilege on advice received in respect of each reportable uncertain tax treatment.

In particular, we recommend that the Minister revise the proposed rules to include certain safeguards applicable in other jurisdictions that require reporting of uncertain tax treatments to ensure that the information collected is administered responsibly and without prejudice to taxpayers. Those protections include:

(a) not requiring disclosure of numerical information that may affect the settlement of an issue;

(b) the clear preservation of a taxpayer's unfettered right to seek advice on a confidential basis and protect any applicable privilege; and

(c) a clear delineation of precisely what information is required so that taxpayers and their advisors have certainty and predictability in the application of the rules.

Proposed Rules Need Appropriate Safeguards

The Draft Legislation does not provide details on the information required to be provided under these proposed rules and no prescribed form has yet been released. However, the Backgrounder sets out an expansive list of information that is expected to be requested for each reportable uncertain tax treatment. Consistent with other jurisdictions, this list includes the relevant taxation year and a description of the relevant facts. However, the proposed list of information also includes, in respect of each the transaction to which a reportable uncertain tax treatment relates:

- a description of "the provisions relied upon for determining the tax payable under the Act" (including provisions of the *Income Tax Act* (Canada) ("**Act**"), the Regulations and other statutes);

- a description of the numerical differences between tax payable, refund of tax or other amount, determined in accordance with relevant financial statements and tax treatment of the corporation's taxation year to which the reportable uncertain tax treatment relates; and

- a description of whether those differences represent permanent or temporary differences, involve a determination of the value of any property and involve a computation of tax basis.

The Backgrounder also states that the requested disclosure may include "such other information" as required by the Minister of National Revenue.

There are notable differences between the overreaching list set out in the Backgrounder and the information required in other jurisdictions. Notably, neither the US nor Australia impose requirements to disclose any amount or reconciliation between taxes payable and amounts determined for financial statement purposes. In fact, disclosure of the maximum tax adjustment or of specific amounts was intentionally deleted during the US consultation process in response to concerns that such disclosure was prejudicial and could

inadvertently reflect a taxpayer's willingness to compromise the particular issue disclosed.[1] This is a particularly relevant concern for positions that may be under consideration by the appeals division, or even in litigation before the courts.

Further, there are no relieving measures in the Draft Legislation to minimize duplication in reporting. For instance, certain transactions that could also be covered by the notifiable or reportable transaction rules must also be included. In comparison, the UK legislation provides an exemption for notification based on certain advance disclosure to UK tax authorities.

We submit that the Minister should follow in the footsteps of other jurisdictions to circumscribe information requested from Canadian taxpayers, impose clear transition guidelines, and minimize duplicative reporting. Minimizing ambiguity in the disclosure requirements and the disclosure burden on taxpayers arising from these new rules is imperative given the very significant consequences of non-compliance. In our view, such changes will not undermine the policy or effectiveness of the rules but will instead give proper recognition to the respective roles of taxpayers and the CRA in a self-assessment system.

Description of Precise Amounts at Issue is Open to Inappropriate Use

In particular, we recommend that the Minister should remove the requirement to disclose amounts or differences between such tax payable, refund of tax or other amount, determined in accordance with relevant financial statements and tax treatment of the corporation. This information does not relate to the stated purpose of the legislation — being to "respond quickly to tax risks". Rather the information is inappropriately focused on the specific quantum of the issue and a taxpayer's potential willingness to compromise on an issue. This information is not necessary to the function of the CRA in verifying tax liability. The other requested information is sufficient for the CRA to identify the emergence of new tax risks and the pervasiveness of the transactions or strategies. The specific tax impact of the transactions or strategies to a particular taxpayer is not relevant to the stated purpose of the new rules nor to the role of the CRA, whose decision to reassess should be based on compliance with the Act, not the potential tax dollars that may be collected.

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[1] IRS, "Announcement 2010-75, Reporting of Uncertain Tax Positions" (24 September 2010), online: https://www.irs.gov/pub/irs-drop/a-10-75.pdf at 6.

In our submission, any prescribed form ought to reflect safeguards of the type that are built into Form 1120 in the US, which requires taxpayers to list only the "primary" sections relating to the tax position, timing codes (whether the difference is temporary or permanent), and the ranking of each tax position based on the amount involved (rather than the precise amounts involved).

Description of all Provisions relied upon Encroaches on Privilege

If the rules are enacted as currently proposed, Canadian tax advisors will be placed in the unenviable position of advising Canadian taxpayers as to how to fully comply with them. This difficulty is exacerbated by the fact that much of the information requested is subjective. For example, it is likely that taxpayers and the CRA may disagree on what constitutes "the provisions *relied upon* for determining the tax payable under the Act" (including provisions of the Act, the Regulations and other statutes). More fundamentally, however, the requested information appears to be seeking the taxpayer's own analysis of the provisions on which it relies; a request that clearly has the potential to engage the interpretation of the legislation, and the advice received by the taxpayer in respect of that legislation.

By contrast, the US Form 1120 only requires identification of the primary provisions involved, without any reference to the taxpayer's reliance thereon, or any requirement to list every provision. Additional safeguards are included in the instructions for the "concise description" of facts in the US form. Those instructions explicitly instruct taxpayers to exclude "assessment of the hazards of a tax position" or analysis related to the tax position. This limitation is essential to the preservation of a taxpayer's right to seek independent advice in respect of the position and preserve any applicable privilege.

Strict limits and guidelines are also necessary in Canada to ensure these rules are not used to erode privilege. Canadian taxpayers must be entitled to maintain privilege with respect to legal advice received in connection with tax issues in the disclosed reporting. The Supreme Court of Canada has emphasized that "[t]he fundamental importance of the right to professional secrecy of lawyers is a cornerstone not only of our judicial system but, more broadly, of our legal system."[2] Canadian taxpayers must have confidence that privilege

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[2] *Canada (Attorney General) v. Chambre des notaires du Québec*, 2016 SCC 20 at para 29; see also *Lizotte v. Aviva Insurance Company of Canada*, 2016 SCC 52 at paras 60 and 64, citing *Canada (Privacy Commissioner) v. Blood Tribe Department of Health*, 2008 SCC 44 at para 9 (privilege is "fundamental to the proper functioning of our legal system").

will be protected, and disclosure should not create any risk of inadvertently waiving privilege. We recommend the legislation be amended to explicitly state that such disclosure does not require the "reporting corporation" to disclose the details of any such related information to which it reasonably believes privilege applies.

The level of detail alluded to in the Backgrounder is particularly troubling in light of the significant penalties, the unclear scope of the due diligence defence, and the potential extension of the applicable limitation period.

Clearer Due Diligence Provision Warranted

Although a due diligence defense exists in the Draft Legislation, it remains unclear as to whether this defence is only limited to a "failure to file" the information return itself or more expansively includes circumstances where a corporation exercises the degree of care, diligence and skill of a reasonable person and inadvertently incorrectly concludes that no reporting was required for a particular reportable uncertain tax treatment on the return.

We recommend that both the penalty and due diligence provisions in the Draft Legislation be amended to clearly distinguish between a Canadian taxpayer that fills out the form on a best-efforts basis and a taxpayer that is deliberately negligent and misrepresents (or deliberately omits) information on the form. We also submit that the legislation and the form should clearly exclude from disclosure interpretive information that may be subject to any applicable privilege.

In the absence of these safeguards, the rules could inadvertently penalize Canadian taxpayers that make genuine mistakes in complying with the disclosure requirements, or could require a Canadian taxpayer to choose between the preservation of privilege and non-compliance with the reporting requirements (and possible penalties or suspension of the normal reassessment period). These changes are essential to the principles of "certainty, predictability and fairness" that have been emphasized by the Supreme Court of Canada as an integral part of the "bedrock of tax law."[3]

Clear Transitional Guidelines Required

The Draft Legislation and Background are silent on necessary transition guidelines and would appear to have retrospective effect as proposed. Legislation should not have

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[3] *Canada v. Alta Energy Luxembourg S.A.R.L.*, 2021 SCC 49.

retrospective effect, except in rare circumstances.[4] For that reason, when similar rules were introduced in the US in 2010, the US tax authorities clarified that a corporation was not required to report a tax position taken in a taxation year that preceded the enactment of the legislation. This was the case even if an uncertain tax position was required to be recorded in audited financial statements in years in which the legislation was deemed effective. In that regard, we note that the uncertainty in respect of a past transaction will typically continue to be reflected in the financial statements until final resolution.

Clear Guidelines Required for Appropriate Use of Information Collected

In connection with this new enhanced disclosure regime, no safeguards have been announced to ensure the information collected will be used responsibly and without prejudice to Canadian taxpayers.

The inclusion of subsection 237.5(7) sends mixed signals about the manner in which information obtained through the Draft Legislation will be used. The clarification that filing an information return for a reportable uncertain tax treatment is "not an admission by the corporation that the tax treatment is not in accordance with the Act and the Income Tax Regulations, or that any transaction is part of a series of transactions" is welcome but also concerning as it raises the question as to what other "admissions" could be perceived in connection with the disclosure. We recommend that subsection 237.5(7) clarify that the recording of a reportable uncertain tax treatment by a taxpayer shall not be considered relevant for the determination of tax payable or other amounts under the Act in respect of that taxpayer, including for purposes of any proceeding before a court.

Finally, an ongoing open and frank dialogue between the CRA and the taxpayer during the audit process is crucial to preserving the integrity of a self-assessment system. The disclosure of reportable uncertain tax treatments creates the risk that the CRA will focus narrowly solely on such disclosure and short-circuit a thoughtful and objective review of other tax issues. From an administrative point of view, we note the IRS, contemporaneous with the introduction of its uncertain tax disclosure rules, implemented a centralized review process to allow for consistent and uniform review of uncertain tax treatments and a Policy of Restraint to ensure that disclosure did not equate to waiver of privilege. We recommend

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[4] Ruth Sullivan, *Sullivan on the Construction of Statutes*, 6th ed (Markham, ON: LexisNexis, 2014) at para 25.76 ("It is presumed that the legislature does not intend legislation to be applied retrospectively, as defined by Driedger, unless the legislation is beneficial or its purpose is to protect the public.").

that similar training and policies be implemented in Canada in conjunction with this proposed measure.

Osler appreciates the opportunity to provide comments. We are hopeful the Minister will reevaluate the scope of these reportable uncertain tax treatment rules in the Draft Legislation and will seek further submissions and feedback from the tax community on any prescribed form released in connection with these disclosures.

Yours very truly,

Osler, Hoskin & Harcourt LLP.

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