

BUDGET 2021: EXPANSION OF MANDATORY DISCLOSURE RULES

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Overview

Budget 2021 proposes to significantly expand the mandatory disclosure rules contained in the *Income Tax Act* (Canada) (the “**Tax Act**”) for the stated purpose of responding to aggressive tax planning in a timely fashion through audits and legislative changes. Drawn in large part from certain recommendations contained in the *Base Erosion and Profit Shifting Project - Action 12 Report* of the Organization for Economic Co-operation and Development and the Group of 20 (the “**BEPS Action 12 Report**”), and with the objective of bringing Canada's mandatory disclosure rules in line with internationally recognized best practices, the announced proposals (and the related draft legislation to be released over the coming weeks) will be the subject of a public consultation process expected to conclude by September 3, 2021.

The mandatory disclosure proposals contemplate (i) changes to the Tax Act's “reportable transaction rules”, (ii) a new regime for reporting so-called avoidance transactions and other “transactions of interest” (known as “notifiable transactions”), and (iii) the mandatory reporting of “uncertain tax treatments” by corporations meeting certain conditions. As discussed in further detail below, taxpayers (along with advisors and promoters) that fail to comply with the new reporting rules may be subject to significant penalties and, in some cases, extended reassessment periods.

Budget 2021 indicates that the new measures will, in the case of uncertain tax treatments, apply to taxation years beginning after 2021, and, in the case of reportable and notifiable transactions, to transactions entered into on or after January 1, 2022 (provided that penalties will not apply to transactions that occur on any date before the enacting legislation receives Royal Assent).

Reportable Transaction Rule Amendments

Section 237.3 of the Tax Act contains the so-called “reportable transaction rules”, the stated objective of which is to assist the Canada Revenue Agency (the “**CRA**”) in identifying certain types of potentially abusive tax avoidance transactions that are not otherwise subject to any specific information reporting requirements under the Tax Act.

In summary terms, a “reportable transaction” is an avoidance transaction (within the meaning of section 245 of the Tax Act), or a series of transactions that includes an avoidance transaction, entered into by or for the benefit of a person, if two of the following three “hallmarks” are present with respect to the transaction(s):

(a) an “advisor” or “promoter” (or certain persons not dealing at arm's length with the advisor or promoter) has an entitlement to a “fee” that is (i) based on the amount of a tax benefit that would result from the avoidance transaction, (ii) contingent upon the obtaining of a tax benefit that results from the avoidance transaction, or (iii) attributable to the number of persons that participate in the avoidance transaction or who have been provided access to advice or an opinion given by the advisor or promoter regarding the tax consequences of the avoidance transaction.

(b) an advisor or a promoter obtains “confidential protection” in specified circumstances in respect of the avoidance transaction. (In general terms, “confidential protection” in respect of a transaction or series of transactions means anything that prohibits the disclosure to any person or to the Minister of National Revenue of the details or structure of the transaction or series of transaction under which a tax benefit results (or would result but for section 245), other than the general disclaiming or restricting of an advisor's liability.)

(c) the person who entered into the avoidance transaction receives “contractual protection” in respect of the avoidance transaction, or an advisor or promoter (or certain persons not dealing at arm's length with the advisor or promoter) receives contractual protection. (In general terms, “contractual protection” means (i) insurance (other than standard professional liability insurance) or other protection that protects against failure to achieve any tax benefit from the transaction or pays for or reimburses any expense, fee, tax, interest, penalty or similar amount that may be incurred by a person in the course of a dispute in respect of a tax benefit from the transaction and (ii) any form of undertaking provided by a promoter that provides assistance in the course of a dispute in respect of a tax benefit from the transaction.)

Under the current rules, a reportable transaction must be reported to the CRA on or before June 30 of the calendar year following the calendar year in which the transaction first became a reportable transaction.

Budget 2021 proposes to broaden the scope of transactions to which the reportable transaction rules apply by requiring that only one of the above-noted hallmarks be present in order for a transaction to be reportable, and expanding the definition of “avoidance transaction” to include any transaction where it can reasonably be concluded that one of the main purposes of entering into the transaction is to obtain a tax benefit.

In addition to expanding the scope of covered transactions, taxpayers entering into a reportable transaction will be required under the new measures to report the transaction to the CRA within 45 days of the earlier of:

(a) the day the taxpayer (or a person on the taxpayer's behalf) becomes contractually obligated to enter into the transaction; and

(b) the day the taxpayer (or a person on the taxpayer's behalf) enters into the transaction.

In addition, promoters and advisors (and certain non-arm's length parties in relation to these persons) would have similar obligations with respect to any scheme that, if implemented, would be a reportable transaction (currently, tax advisors or promoters are only required to disclose "reportable transactions" in which they receive certain contingent fees), subject to the continuing exception in the case of solicitor-client privilege - an exception which, given the expanded breadth of reportable transactions contemplated under the amended rules, along with those contemplated under the new notifiable transaction rules discussed below, may prove to be even more important in future periods.

Notifiable Transactions

In addition to the "generic" hallmarks contained in the reportable transaction rules discussed above, Budget 2021 proposes, with reference and embracement of the BEPS Action 12 Report and the practices adopted in certain countries such as the United States, the United Kingdom and Australia, a mandatory disclosure regime respecting what are referred to as "specific hallmarks" focusing on particular transactions and areas of concern, with the objective of allowing the government to quickly develop targeted and appropriate responses to same.

Specifically, Budget 2021 seeks to enact measures designed to provide the CRA with relevant information on a timely basis relating to particular tax avoidance transactions (or series of transactions) and other "transactions of interest" - referred to in the proposals as "notifiable transactions". The new measures would not, in and of themselves, impact the tax treatment of the particular transactions to which they apply. Rather, they are intended, according to Budget 2021, to provide the CRA with more timely information with respect to transactions that it may wish to challenge, and to reduce the number of situations where the CRA is faced with the additional burdens of working outside the normal reassessment period.

As proposed, the Minister of National Revenue will have the authority to designate, with the concurrence of the Minister of Finance, a transaction as a "notifiable transaction", which, similar to the approach taken by the United States, would include both transactions that the CRA has found to be abusive and transactions identified as "transactions of interest".

Budget 2021 indicates that each notifiable transaction under the new regime would set out "the fact patterns or outcomes" necessary to allow taxpayers to determine whether a particular transaction is considered "notifiable". Examples of notifiable transactions are expected to be released during the public consultation period mentioned above.

Similar to the reportable transaction measures, a taxpayer (or certain other persons on the taxpayer's behalf) entering into a notifiable transaction - *or any transaction or series of transactions that is substantially similar to a notifiable transaction* - would be required to report the transaction or series to the CRA in prescribed form within 45 days of the earlier of:

- (a) the day the taxpayer (or other person) becomes contractually obligated to enter into the transaction or series; and
- (b) the day the taxpayer (or other person) enters into the transaction or series.

In addition, any promoter or advisor (and certain parties not dealing at arm's length with such persons) offering a "scheme" that, if implemented, would be a notifiable transaction (or substantially similar to a notifiable transaction), will be required to report the transaction within the same time limits, subject to an exception in the case of solicitor-client privilege.

Consequences of Failing to Comply with New Reporting Rules

Extended Reassessment Period

The "normal reassessment period" under the Tax Act generally runs for three or four years (depending on the type of taxpayer) from the date the relevant tax return is assessed.

Assessments beyond the normal reassessment period require that certain additional burdens be satisfied by the CRA, including the requirement that the CRA prove that the taxpayer made a misrepresentation on its tax return that was attributable to neglect, carelessness or wilful default, something which the Budget 2021 materials describe as being "challenging and time consuming" for the CRA.

In support of the amended reportable transaction rules and new notifiable transaction rules, Budget 2021 provides that where a taxpayer has a reporting requirement in respect of a transaction relevant to the taxpayer's income tax return for a taxation year, the normal reassessment period will not begin in respect of the transaction until the taxpayer has complied with the reporting requirement (with the result that a reassessment of a year in respect of a transaction would not become statute-barred in cases where there is a reporting compliance failure).

Penalties

A taxpayer that does not file a required form to disclose a reportable transaction or a notifiable transaction in accordance with the Budget 2021 proposals will face a penalty of \$500 per week to up to the greater of \$25,000 and 25% of the tax benefit. A promoter or advisor will face a penalty equal to (i) the fees received, plus (ii) \$10,000, plus (iii) \$1,000 per day, during which the failure continues, to a maximum of \$100,000.

Uncertain Tax Treatment Reporting

Under applicable Canadian GAAP and IFRS requirements, an entity concluding that it is not probable that the relevant “taxation authority” (in the Canadian context, the courts) will accept a particular “uncertain tax treatment” (with the result that it is probable that the entity will receive or pay amounts relating to the uncertain tax treatment) must reflect the effect of that uncertain tax treatment in its financial statements.

Again drawing from the practices of other countries (most notably, the United States), and for stated purposes substantially paralleling those given for the expanded reporting rules described above, Budget 2021 proposes that certain corporate taxpayers otherwise required to file a corporation tax return be required to report uncertain tax treatments on an annual basis to the CRA, where each of the following conditions are satisfied:

- (a) the corporation has at least \$50 million in assets at the end of the financial year (based on carrying value) that coincides with the taxation year (or the last financial year that ends before the end of the taxation year);
- (b) the corporation, or a related corporation, has audited financial statements prepared in accordance with IFRS or other country-specific GAAP relevant for domestic public companies (e.g., U.S. GAAP); and
- (c) uncertainty in respect of the corporation's Canadian income tax for the taxation year is reflected in those audited financial statements (i.e., it is probable that the entity will receive or pay amounts relating to the uncertain tax treatment).

Corporations subject to these proposed rules (which, it is observed, should exclude many private companies not required to use IFRS, along with transactions giving rise to tax amounts that are determined to be less than the applicable materiality threshold) would be required to provide certain prescribed information at the time the relevant corporate tax return is filed, including the quantum of taxes at issue, a “concise” description of the relevant facts, the tax treatment taken, and whether the uncertainty relates to a permanent or temporary difference in tax.

In support of these new reporting requirements for uncertain tax treatments, Budget 2021 proposes a penalty for each failure to report a particular uncertain tax treatment of \$2,000 per week to a maximum of \$100,000 (per failure).

Conclusions

The proposals in Budget 2021 contemplate a significantly expanded scope of reporting obligations, backed with the prospect of material penalties for non-compliance for taxpayers, advisors and promoters, along with the possibility of an extended reassessment period in respect of unreported transactions. It will be interesting

to see if the legislation, when released, contains any exceptions relating to circumstances where taxpayers have, in good faith, determined that the rules were not applicable. In the absence of such accommodations, it seems that the new measures will have (as is most likely intended) the effect of compelling taxpayers and other affected persons to adopt a “when in doubt, report” approach to the rules.

It also remains uncertain as to the degree of incremental compliance effort and costs that will be associated with the proposed measures, something which the consultation process may help illuminate.

By [Todd Miller](#)

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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