



1200 G Street, N.W., Suite 300
Washington, D.C. 20005-3814
202.638.5601
tei.org

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Chief Tax Counsel

The Honourable Chrystia A. Freeland, P.C., M.P.
Deputy Prime Minister and Minister of Finance
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5
Canada

Re: Proposed Changes to Canada's Income Tax Mandatory Disclosure Rules

Dear Minister Freeland:

On behalf of Tax Executives Institute, Inc. ("TEI"), I am pleased to share our initial comments on the proposed amendments to Canada's income tax mandatory disclosure rules as described in the federal budget documents tabled in the House of Commons on April 19, 2021 ("Budget 2021").¹ In particular, our comments concern the government's proposals to amend the Income Tax Act's reportable transaction rules and introduce a new requirement for specified corporations to proactively report uncertain tax positions to the Canada Revenue Agency ("CRA").

About TEI

TEI was founded in 1944 to serve the professional needs of in-house tax professionals. Today, the organization has 57 chapters across North and South America, Europe, and Asia, including four chapters in Canada. Our approximately 6,500 members represent 2,800 of the world's leading companies, many of which either are resident or do business in Canada. Over 15 percent of TEI's membership comprises tax professionals who work for Canadian businesses in a variety of industries across the country. TEI members are responsible for the tax affairs of their employers and must contend daily with provisions of the tax law relating to the operation of business enterprises. The following recommendations reflect the views of TEI as a whole but, more particularly, those of our Canadian constituency.

¹ Dep't of Fin. Can., Budget 2021, Annex 6, *Tax Measures: Supplementary Information* 629-39 (Apr. 19, 2021).

As the preeminent association of in-house tax professionals worldwide, TEI is dedicated to the development of sound tax policy, compliance with and uniform enforcement of tax laws, and minimization of administration and compliance costs to the mutual benefit of government and taxpayers. TEI is committed to fostering a tax system that works—one that is administrable and with which taxpayers can comply in a cost-efficient manner. The diversity, professional training, and global viewpoints of our members enable TEI to bring a balanced and practical perspective to the legislative proposals discussed herein.

Discussion

TEI appreciates the government's invitation to provide comments on the proposed changes to Canada's income tax mandatory disclosure rules described in Budget 2021, as well as on any forthcoming draft legislation. In anticipation of the latter's release, however, TEI felt it prudent to share our preliminary feedback concerning the contemplated scope and application of the proposed measures in an effort to inform the government's deliberations.

Reportable Transactions

Under existing law, taxpayers are required to report certain "avoidance transactions," as defined for purposes of the Income Tax Act's general anti-avoidance rule.² In general, these "reportable transactions" are avoidance transactions that bear at least two of three statutorily prescribed "generic hallmarks" of tax avoidance. The Act requires certain persons who facilitate or benefit from a reportable transaction to file an information return with the CRA by June 30 of the calendar year following the calendar year in which the reportable transaction first arose.

To address perceived limitations of the current regime and bring it in line with international best practices, Budget 2021 proposes to amend the Act's reportable transaction rules by lowering the threshold for reportable transactions—requiring the presence of only one generic hallmark of tax avoidance. It also proposes to amend the definition of "avoidance transaction" for these purposes so that a transaction would be considered an avoidance transaction if it can reasonably be concluded that one of the main purposes of entering into the transaction is to obtain a tax benefit. Additionally, the aforementioned reporting deadline would be changed to within a mere 45 days of the day the taxpayer enters into the transaction or becomes contractually obligated to do so, whichever is earlier.

TEI is concerned that, if not carefully drafted, this proposal could result in taxpayers being required to report voluminous amounts of inconsequential information to the CRA, which would make it *harder*—*not easier*—for the CRA to identify and react quickly to tax avoidance risks through informed

² See I.T.A. § 237.3. Unless otherwise indicated, all references to "section" or "§" herein are to sections of the Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), as amended ("Act" or "I.T.A.").

risk assessments, audits, or changes to legislation. For example, based on the description provided in Budget 2021, TEI members are concerned that typical withholding tax gross-up clauses found in many standard commercial agreements could result in such transactions being considered reportable transactions under the proposal. TEI views this as an inappropriate—but plausible—result of the proposal as currently described in Budget 2021. TEI recommends taxwriters provide detailed guidance clarifying that an “avoidance transaction” should not include these types of ordinary course, bona fide commercial arrangements. TEI also recommends that taxwriters provide similar clarity with respect to the proposed new class of “notifiable transactions” and, in particular, the proper interpretation of the phrase “to procure a tax benefit to a taxpayer.” Finally, TEI notes that the proposed 45-day reporting deadline would pose a significant compliance hurdle for taxpayers and could adversely impact the quality of information submitted to the CRA.

Reporting Uncertain Tax Treatments

Budget 2021 proposes the introduction of a new federal requirement for specified corporations to proactively report uncertain tax treatments to the CRA. As described in Budget 2021, an “uncertain tax treatment” would be a tax treatment used, or planned to be used, in an entity’s income tax filings for which there is uncertainty over whether the tax treatment will be accepted as being in accordance with tax law. In general, the proposed reporting requirement would apply to corporate taxpayers that meet certain criteria, including:

- at least \$50 million in assets at the end of the financial year that coincides with the taxation year;
- audited financial statements prepared in accordance with IFRS or other country-specific GAAP relevant for domestic public companies; and
- uncertainty in respect of the corporation’s Canadian income tax for the taxation year that is reflected in its audited financial statements.

In describing the proposal, Budget 2021 explains that comparable foreign jurisdictions like the United States, Australia, and the United Kingdom have introduced (or are in the process of introducing) reporting requirements related to uncertain tax positions. Budget 2021 posits that the introduction of a similar reporting regime in Canada would allow the CRA to more efficiently administer and enforce the Act.

While the details of the proposed reporting requirement have yet to be released in the form of draft legislation, TEI notes that the description provided in Budget 2021 contemplates a Canadian regime that would be much broader in scope and application than that of the United Kingdom. For example, the U.K. legislation includes a reporting threshold whereby an uncertain tax treatment is reportable only in cases where the aggregate tax advantage is reduced by more than £5 million (~\$8.4 million). Moreover, the pending U.K. regime will apply only to corporations and partnerships with U.K. turnover in excess of £200 million (~\$336 million CAD) per annum or a U.K. balance sheet (asset) total of over £2 billion (~\$3.36 billion), compared to a proposed asset threshold of only \$50 million in

Budget 2021. TEI believes that adopting quantitative thresholds similar to those pending adoption in the United Kingdom would help to rationalize the sheer number of taxpayers—and transactions—potentially subject to the proposed reporting requirement in Canada. TEI would also recommend that the proposed asset threshold specify that it would apply only to assets situated in Canada.

Public Consultation on Release of Draft Legislation

As explained by a pair of senior Department of Finance (“Department”) officials, federal tax legislation in Canada is normally released in draft form for public consultation. The public is provided the opportunity to comment on draft legislative proposals, usually for a period of 60–120 days, and comments received are considered in finalizing the legislation before its introduction in Parliament.³

TEI believes that a robust public consultation process is essential to the development and implementation of sound tax policy. The proposed changes to Canada’s income tax mandatory disclosure rules are no exception, and TEI urges the Department to provide stakeholders with a meaningful opportunity (i.e., 60–120 days) to comment on any forthcoming draft legislation.

Implementation, Administration, and Compliance Concerns

Notwithstanding the government’s suggestions to the contrary, the proposed changes to Canada’s income tax mandatory disclosure rules described in Budget 2021 would impose significant additional compliance and reporting obligations on affected taxpayers, requiring substantial investments of taxpayer time and resources to develop the necessary systems and processes to comply. TEI member experience bears this out; many TEI members from across Canada endured significant challenges in implementing systems and processes to comply with other reporting measures, such as the EU Council Directive 2011/16 in relation to cross-border tax arrangements, known as DAC6. Some of the administrative challenges TEI members would face if the proposed changes described in Budget 2021 were enacted include:

- gaining a clear understanding of what transactions fall within scope of the rules;
- devising internal red flags and other processes for identifying reportable transactions;
- establishing systems and processes for capturing and storing relevant transaction data;
- establishing systems and processes for reporting any reportable transactions to the CRA;
- updating customer agreements to address the potential reporting of transactions to the CRA and customer cooperation therewith; and
- establishing new employee-training processes, including guides and live sessions.

In view of the above, TEI is concerned that the contemplated 2022 effective dates of the proposed measures would not provide a reasonable opportunity for the CRA or taxpayers to

³ Brian Ernewein & Nancy Horsman, *The Process for Making Tax Policy in Canada*, 61 Can. Tax J. 1031, 1034 (2013).

implement the necessary systems and processes to properly administer and comply with the new rules. If draft legislation is not released for public consultation until late 2021 or early 2022, then it is unlikely that any rules would be finalized until late 2022 or early 2023. Accordingly, TEI respectfully submits that it would be neither appropriate nor realistic for these proposed measures to take effect before 2024.

Based on TEI member experiences with similar reporting regimes in other countries, there is no question the CRA will need ample time to develop the requisite systems and expertise to process—and actually use—the information once it is reported. TEI cautions, therefore, that failure to adopt the later effective dates recommended above would result in taxpayers devoting substantial amounts of time and resources to capture and report information that would not be used in a meaningful way in tax administration. The CRA's ability to use taxpayer-reported information effectively and efficiently will also be directly impacted by the volume and relevance of the information received. TEI asserts, therefore, that it would be advantageous for the government to spend time at the outset tailoring the breadth and depth of the proposed measures to ensure they capture only the most useful information and exclude ordinary course business transactions as discussed above.

TEI appreciates the opportunity to share our preliminary feedback at this stage and looks forward to engaging in meaningful, substantive consultations with Department and CRA officials following the release of draft legislation. TEI members stand ready to assist the Department and the CRA in their efforts to strike the appropriate balance between risk reduction and administrability in furtherance of the government's policy aims.

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These comments were prepared under the aegis of TEI's Canadian Income Tax Committee, whose chair is Patricia Likogiannis. Principal responsibility for drafting TEI's comments was exercised by Watson M. McLeish, TEI Tax Counsel. If you have questions about TEI's comments, please contact Ms. Likogiannis at (905) 431-4565 or patricia.likogiannis@gm.com, or Mr. McLeish at (202) 470-3600 or wmcleish@tei.org.

Respectfully submitted,



Mitchell S. Trager
International President

Copies: Shawn D. Porter, Associate Assistant Deputy Minister, Tax Legislation, Tax Policy Branch
Trevor McGowan, Director General, Tax Legislation Division, Tax Policy Branch