TAX EXECUTIVES INSTITUTE

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

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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: Income Tax Mandatory Disclosure Rules Consultation

Dear Minister Freeland:

On behalf of Tax Executives Institute, Inc. ("TEI"), I am writing to comment on the draft legislative proposals released by the Department of Finance Canada ("Department") on February 4, 2022, to amend Canada's income tax mandatory disclosure rules.[1] These proposals were initially described in the federal budget documents tabled in the House of Commons on April 19, 2021 ("Budget 2021"),[2] on which TEI provided preliminary feedback last fall.[3] That feedback is incorporated by reference herein.

TEI appreciates this opportunity to comment on the draft legislative proposals and respectfully urges the Department to take our comments into account in finalizing the legislation before its introduction in Parliament. As set forth below, TEI remains deeply concerned about the overbreadth of these proposals and the immense compliance and administration challenges posed thereby.

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[1] Dep't of Fin. Can., *Legislative Proposals Relating to Income Tax Act And Other Legislation*, cls 40–46 (Feb. 4, 2022).

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

[3] Letter from Mitchell S. Trager, Int'l President, Tax Exec. Inst., to Hon. Chrystia A. Freeland, P.C., M.P., Deputy Prime Minister & Minister of Fin., Dep't of Fin. Canada (Dec. 10, 2021), https://www.tei.org/advocacy/submissions/tei-comments-proposed-changes-canadas-income-tax-mandatory-disclosure-rules.

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% of TEI's membership comprises tax professionals who work for Canadian businesses in a variety of industries across the country. The following recommendations reflect the views of TEI as a whole but, more particularly, those of our Canadian constituency.

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

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.[4] In general, these "reportable transactions" are avoidance transactions that bear at least two of three statutorily prescribed "generic hallmarks" of tax avoidance. Very generally, those hallmarks are: (1) a promoter or tax advisor is entitled to contingent fees based on tax benefits obtained from the transaction or the number of taxpayers who participate therein; (2) a promoter or tax advisor requires "confidential protection" with respect to the transaction; and (3) the taxpayer or certain other persons obtain "contractual protection" with respect to the transaction, including certain forms of insurance against a failure to achieve the intended tax benefit.

A reportable transaction includes all the transactions in a series of transactions if at least one of the transactions in the series is an avoidance transaction. 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. Where more than one person is required to file an information return in respect of a reportable transaction, however, the filing of a complete and accurate return by one person will satisfy any other's requirement to do so.

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[4] *See* I.T.A. § 237.3.

To address perceived limitations of the current regime and bring it in line with international best practices, the draft legislation would amend the Act's reportable transaction rules by lowering the threshold for reportable transactions by:

- amending the definition of "avoidance transaction" to mean 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;

- requiring the presence of only one generic hallmark of tax avoidance;

- amending the "contractual protection" hallmark to provide an exclusion from reporting requirements regarding contractual protection offered in the context of normal commercial transactions to a wide market;

- eliminating the existing relief from duplicative reporting where more than one person is required to file an information return in respect of a reportable transaction; and

- accelerating the reporting deadline 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 remains concerned that, if enacted in their current form, these proposals would 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 risk assessments, audits, or changes to legislation. Most notably, by requiring the presence of only one generic hallmark of tax avoidance, the proposals would result in the mandatory disclosure of routine business contracts with ordinary course confidentiality or non-disclosure covenants and common representations, warranties, or indemnities.

Confidential Protection

Many standard agreements have confidentiality provisions intended to protect commercially sensitive information (e.g., pricing, timing of proposed transactions) unrelated to tax planning or potential tax benefits. Indeed, many commercial discussions begin only after such non-disclosure agreements are reached. TEI recommends, therefore, that the Department revaluate the efficacy its proposal to lower the threshold for reportable transactions by requiring the presence of only one generic hallmark of tax avoidance. Alternatively, TEI would urge the Department to at least amend the confidential protection hallmark by limiting its scope to cover only those confidentiality protections that are specifically related to an avoidance transaction.

Contractual Protection

TEI appreciates the Department's proposal to amend the "contractual protection" hallmark to provide an exclusion from the reporting requirements for certain types of contractual protections that are offered in the context of normal commercial transactions to a wide market. As currently drafted, the exclusion would apply to contractual protection that is "offered to a broad class of persons and in a normal commercial or investment context in which parties deal with each other at arm's length and act prudently, knowledgeably and willingly." Without more, however, TEI is concerned that the proposed exclusion would not have its intended effect; normal commercial transactions could still be caught because the draft legislation does not qualify the meaning of "offered to a broad class of persons."

It is common practice for certain indemnities to be offered to counterparties in negotiated transactions, as opposed to a "broad class of persons." For example, it is normal in M&A transactions for an indemnity to be provided by a seller to an acquirer for pre-closing taxes, or by an acquirer to a seller for taxes incurred on a pre-closing reorganization that the acquirer requested take place. Similarly, a gross-up clause for withholding taxes is a standard commercial term that may be offered to a particular counterparty in a loan or ISDA agreement based on a negotiated deal, but not to a "broad class of persons." While these and other contractual protections are commonly used in normal commercial or investment contexts in which parties deal with each other at arm's length, they are not "offered to a broad class of persons." The obvious risk, therefore, is that many normal, arm's length commercial transactions would be considered reportable transactions under the draft proposals.

TEI respectfully recommends that the Department revise the draft legislation to affirmatively clarify that an "avoidance transaction" does not include these types of ordinary course, bona fide commercial arrangements. TEI further recommends that the Department remove or appropriately reformulate the draft legislative language, "offered to a broad class of persons," discussed above.

Duplicative Reporting

Additional concerns arise form the draft proposal to eliminate the Act's existing relief from duplicative reporting where more than one person is required to file an information return in respect of a reportable transaction. It is unclear what, if any, benefit would be realized by the CRA from such duplicative reporting. Parties would either report identical information, in which case the CRA would have to process additional returns with no change in the information reported, or they would report inconsistent information (in form, not in substance), in which case the CRA would have to devote additional time and resources to reconciling the inconsistent information returns. Enacting this proposal would also sharply deviate from international best practices, given that other jurisdictions with similar mandatory disclosure regimes—including the European Union and the United Kingdom—permit a single disclosure to satisfy the obligations of all parties in respect of a particular transaction or series of transactions. TEI respectfully recommends, therefore, that the Department

revise its draft legislation to retain the Act's existing relief from duplicative reporting where more than one person is required to file an information return in respect of a reportable transaction.

Reporting Deadline

Finally, TEI remains profoundly concerned with the proposed 45-day reporting deadline, which would not only pose an impracticable compliance hurdle for taxpayers but also adversely impact the quality of information reported to the CRA. Given the broad scope—and proposed lower threshold—of the reporting requirements, tax departments in many cases will not have the means to identify or track when reportable transactions are entered into, especially in instances where transactions are confidential until fully executed. Accordingly, TEI urges the Department to replace this draft proposal with a more reasonable—and workable—alternative, such as one that would make the reporting deadline coincide with the person's regular tax return filing deadline for the tax year in which the reportable transaction arose.

Notifiable Transactions

To further assist the CRA in identifying certain tax avoidance transactions and other transactions of interest on a timely basis, the draft legislative proposals would create a new reporting regime with respect to "notifiable transactions." Under the proposed approach, the Minister of National Revenue would have the authority to designate, with the concurrence of the Minister of Finance, a transaction as a notifiable transaction. To this end, the draft proposals include descriptions of "sample notifiable transactions" that have been so designated by the Minister of National Revenue. In general, the proposed legislation would require a taxpayer who enters into a notifiable transaction, or a transaction that is substantially similar to a notifiable transaction, to report the transaction in prescribed form to the CRA within 45 days. The draft proposals further provide that the phrase "substantially similar" is to be interpreted broadly in favour of disclosure.

TEI is concerned that the broad scope of the draft legislative language would imbue a significant—and inappropriate—degree of subjectivity into the determination of whether a transaction is subject to mandatory disclosure. Without more detailed guidance—and examples—on how to interpret and apply the proposed reporting regime, the resulting uncertainty would only sow the seeds for new, unproductive disputes between taxpayers and the CRA. TEI therefore urges the Department to work proactively with the CRA to promulgate a more definitive list of designated transactions to replace the proposed subjective, broad-based rule.

Back-to-Back Arrangements

One category of sample notifiable transactions described in the draft proposals involves the use of certain back-to-back lending and other arrangements intended to circumvent the Act's thin-capitalization rules or Part XIII withholding tax. TEI cautions, however, that there is also a range of

legitimate products/solutions in the marketplace such as notional pooling and cash concentration that are offered by financial institutions to multinational corporations for commercial purposes. Consistent with TEI's threshold recommendation above, therefore, the Department and CRA must provide more detailed guidance and concrete examples so that taxpayers can understand the government's concern and when there is a requirement to disclose. This is merely an example of one area where, without more, the draft proposals would lead to increased uncertainty, subjectivity in interpretation, and controversy between taxpayers and the CRA.

Requirement to File Return

TEI is similarly concerned about the breadth of "persons" that would be required to file information returns with respect to a reportable transaction under the proposed legislation. As currently drafted, such persons would include "every advisor . . . in respect of the notifiable transaction," which is defined to mean each person who provides any assistance or advice with respect to creating, developing, planning, organizing, or implementing the notifiable transaction to another person. This definition is so all-encompassing that it would easily apply to persons who are only tangentially involved with a particular notifiable transaction.

Consider, for example, the simple case of an entity that makes a loan in the ordinary course of its business to a taxpayer who is entering into a notifiable (or substantially similar) transaction. Under the current proposal, both the taxpayer *and* the lender would be required to report the transaction in prescribed form to the CRA within 45 days. Such a rule would require lending institutions to discern the purpose of all loans made to customers, imposing an enormous administrative burden on institutions and customers alike. Another example could be a situation where a taxpayer seeks advice regarding the financial accounting (not tax) implications of a notifiable transaction and indirectly creates a reporting requirement for the accounting firm, which may not be privy to the entire transaction or otherwise have access to the information required to make a proper disclosure.

In view of these obviously incongruous results, TEI recommends that the Department narrow the scope of advisors subject to the proposed reporting requirement to include only those who provide direct assistance with respect to the transaction. TEI further recommends that the Department revise the definition of "advisor" for this purpose to include only *tax* advisors related to the notifiable transactions.

Reportable Uncertain Tax Treatments

As previewed in Budget 2021, the draft legislative proposals would introduce a new federal requirement for specified corporations to proactively report uncertain tax treatments to the CRA. An uncertain tax treatment for this purpose is described as 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. Under the draft legislation, a corporation would

generally be required to report an uncertain tax treatment in respect of a taxation year where the following conditions are met:

- the corporation is required to file a Canadian federal income tax return (i.e., the corporation is a resident of Canada or has a taxable presence in Canada);
- the corporation has at least $50 million in assets at the end of the financial year that coincides with the taxation year;
- the corporation has 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 is reflected in those audited financial statements.

In first describing this proposal in Budget 2021, the Department explained that comparable foreign jurisdictions like the United States, Australia, and the United Kingdom had introduced (or were in the process of introducing) reporting requirements related to uncertain tax positions. Instead of proposing to implement a similar reporting regime in Canada, however, the draft legislation 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 (~$8.2 million). Moreover, the pending U.K. regime will apply only to corporations and partnerships with U.K. turnover in excess of £200 million (~$327 million) per annum or a U.K. balance sheet (asset) total of over £2 billion (~$3.27 billion), compared to a proposed asset threshold of only $50 million in the draft legislation. TEI believes that adopting quantitative thresholds closer 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 also recommends that the Department refine the proposed asset threshold to specify that it would apply only to assets situated in Canada.

Finally, TEI respectfully recommends that the Department revise the draft legislation to provide an explicit exception to the proposed reporting requirement to the extent that solicitor-client privilege applies. Other exceptions should be available to the extent that information has been disclosed through CRA audit inquiries and in pending litigation circumstances.

Implementation, Administration, and Compliance Concerns

Notwithstanding the Department's suggestions to the contrary, the proposed changes to Canada's income tax mandatory disclosure rules set forth in the draft legislation 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 taxpayers would face if the draft legislative proposals are 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 remains deeply concerned that all three legislative proposals discussed herein, as currently drafted, would apply to taxation years (and transactions occurring in taxation years) beginning after December 31, 2021. Such an effective date obviously would not provide a reasonable opportunity for the CRA or taxpayers to implement the necessary systems and processes to properly administer and comply with the new rules. The draft legislation was just released for public consultation in February, therefore 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 experience with similar reporting regimes in other countries, there is no question that 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 recommended post-2023 effective date 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 would also be directly impacted by the volume and relevance of the information received. TEI respectfully asserts, therefore, that it would be advantageous for the government to spend time at the outset tailoring the breadth and depth of not only the proposed measures but also the associated forms to ensure they capture only the most useful information and exclude ordinary course business transactions, as discussed above. To that end, TEI stands 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