Mandatory Disclosure Rules Receive Royal Assent

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The Mandatory Disclosure Rules (the "**New Rules**") received royal assent on June 22, 2023, as part of Bill C-47. The New Rules will amend the *Income Tax Act* (the "**Act**") to expand the scope of tax-incentive carrying transactions that are subject to mandatory disclosure. Accordingly, it is important for taxpayers, advisors, and promoters to be aware of their disclosure obligations to avoid penalties.

Overview

The New Rules will require taxpayers, advisors, or promoters to file a prescribed information return relating to the transaction (which for the purposes of this article, includes a series of transactions) that triggers the disclosure requirement. The New Rules set out the following three regimes that can trigger disclosure requirements:

1. Reportable transactions
2. Notifiable transactions
3. Uncertain tax treatments

In addition to expanding the scope of transactions that will trigger disclosure, the New Rules will extend the reassessment period for any transaction up to a maximum of four (4) years, depending on the regime the transaction falls under.

1. Reportable transactions

Under the reportable transactions' regime, a prescribed information return is required to be filed by the taxpayer within 90 days of either entering into the transaction or becoming contractually obligated to enter into the transaction, whichever is earlier. Penalties for late filing can range from $2,000 per week per unreported item up to a maximum of $100,000.

When enacted, the New Rules will lower the threshold that is currently required for a transaction to be categorized as a "reportable transaction." *Under the current rules*, a transaction is considered a reportable transaction if it meets **both** of the following criteria:

- the **primary purpose** of the transaction is to obtain a tax benefit.

- If the transaction meets **at least two (2)** of the three “hallmarks” set out under the rules.

Under the New Rules, a transaction will be a reportable transaction if it meets **both** of the following criteria:

- It can reasonably be concluded that **one of the main purposes** of entering into the transaction is to obtain a tax benefit; and
- The transaction meets **at least one (1)** of the hallmarks set out under the rules (see below).

The reportable transactions regime sets out the following generic hallmarks:

(a) Tax benefit-based fees

The tax benefit-based fees hallmark includes, but is not limited to, transactions where the advisor or promoter may receive a fee that is contingent on a tax benefit or the amount of the fee being based on the tax benefit created. Moreover, this hallmark will be met in cases where the fees charged by the advisor or promoter are based on the quantity of taxpayers involved in, or are given access to the advice regarding the tax implications of, the transaction.

It is important to note that claims for the Scientific Research and Experimental Development (**SR&ED**) program are exempt from this hallmark.

(b) Confidential protection

The confidential protection hallmark captures transactions where the promoter or advisor requires that the client be prohibited from disclosing the details or structure of a transaction involving a tax treatment to any person or to the Minister of National Revenue.

(c) Contractual protection

The contractual protection hallmark encompasses transactions where the taxpayer, promoter, or advisor (or certain non-arm’s length persons) is granted contractual protection, including any form of insurance or any undertaking provided by a promoter that aids a person in a dispute about the tax benefit, other than professional liability insurance.

It is important to note that the definition of contractual protection for the purposes of the New Rules excludes insurance or other protections that are integral to arm’s length agreements for the purchase and sale of a business. Therefore, the definition excludes M&A transactions where it is reasonable to believe that the protection is to ensure that the acquisition cost factors in any liabilities of the business immediately prior to the sale and is obtained primarily for bona fide purposes other than to achieve a tax benefit from the transaction.

2. Notifiable transactions

The notifiable transactions regime brings an entirely new category of transactions that trigger disclosure obligations. This regime is triggered when a transaction resembles designated avoidance transactions set out by the Federal Government (see below). Moreover, disclosure obligations are triggered under this regime when a transaction is the same as, or is **substantially similar** to, a designated transaction. For the purposes of this regime, the meaning of “substantially similar” will be interpreted broadly in favour of disclosure and will extend to transactions carrying the same or similar types of tax implications to the designated transactions.

According to a Department of Finance article on the New Rules, the following types of transactions have been designated as notifiable transactions:

- Avoiding “Canadian corporation” status or “Canadian controlled” status to avoid anti-deferral rules applicable to investment income;
- Creating loss straddle transactions using a partnership;
- Avoiding the 21-year deemed disposition of trust property;
- Manipulating bankruptcy status to reduce a forgiven amount relating to a commercial obligation;
- Relying on purpose tests in an anti-avoidance rule relating to tax attribute trading restrictions to avoid a deemed acquisition of control; and
- Using back-to-back arrangements to circumvent the thin capitalization and non-resident withholding tax rules.

If disclosure obligations are triggered under the notifiable transactions regime, reporting requirements and corresponding penalties are generally the same as for the reportable transactions regime.

3. Uncertain Tax Treatments

Uncertain tax treatments arise when a tax position is taken in a corporation’s income tax return that conflicts with the findings of the corporation’s audited financial statements for the taxation year. Only corporate taxpayers are subject to disclosure requirements under this regime and to trigger disclosure requirements the corporation must meet **all** of the following conditions:

- The corporation is required to file a Canadian income tax return and has **at least $50 million** in assets at the end of the relevant tax year;
- The corporation, or a group of which the corporation is a member, has audited financial statements prepared in accordance with International Financial Reporting Standards or other country-specific generally accepted accounting principles relevant for corporations that are listed on a stock exchange outside Canada; and
- There is an uncertain tax treatment related to the corporation’s Canadian income tax that is reflected in the audited financial statements of the corporation or of a group of which it is a member.

A tax treatment that falls under this regime will require a prescribed information return that is due at the same time as the corporation’s Canadian income tax return for the relevant taxation year. Penalties for late filing will range from $2,000 per week per unreported item, up to a maximum of $100,000.

Please contact one of our **TDS Tax Lawyers** for advice on how you can navigate the New Rules.
