# TAX IN MOTION

# Decoding the latest changes to disclosure and anti-avoidance rules

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# Your speakers

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TAX IN MOTION
2023 CANADA FORUM

# Agenda

1. Mandatory Disclosure Rules
2. General Anti-Avoidance Rule
3. Budget 2023 Mandatory Disclosure Rules Proposals
4. Questions and Answers

## Learning objectives

By the end of this presentation, participants will be able to:

1. Provide an overview of the amendments to the GAAR and the new mandatory disclosure rules
2. Demonstrate the implications of the GAAR proposal and MDR
3. Discuss a few practical issues/concerns that are critical for taxpayers and their advisors

# Mandatory disclosure rules

# Mandatory disclosure rules

**Quick Facts**
- Creates new disclosure requirements
- Came into force June 22, 2023
- Expanded on prior rules
- May capture ordinary tax planning

**Sections**
- Reportable Transactions
- Notifiable Transactions
- Reportable Uncertain Tax Treatment

**Filing Deadlines**

**Reportable and Notifiable Transactions**

90 days after the earlier of:
- When the transaction is entered into and
- When the person becomes contractually obligated to enter the transaction*

**Reportable Uncertain Tax Treatment**

Income Tax Filing Deadline

**Reporting Forms**

RC312 – Reportable and Notifiable Transactions
RC3133 – Reportable Uncertain Tax Treatment

# Reportable transactions

Reportable transaction

- An avoidance transaction and each transaction in a series of transactions that includes the avoidance transaction, if a hallmark applies in respect of the transaction or series.

Avoidance transaction

- A transaction where 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.

Hallmarks

- Contractual protection – Tax-result protection
- Confidential protection – Tax treatment confidentiality
- Contingency fee – Fees based on the tax benefit or number of people

# Notifiable transactions

Notifiable Transaction

- Designated transactions and transactions substantially similar to them, as well as designated series of transactions and substantially similar series of transactions.

Substantially Similar

- Interpreted in favour of disclosure
- Transactions that are:
  - Expected to obtain the same or similar types of “tax consequences”,
  - Factually similar
  - Based on the same or similar tax strategy.

# Reportable and notifiable transactions

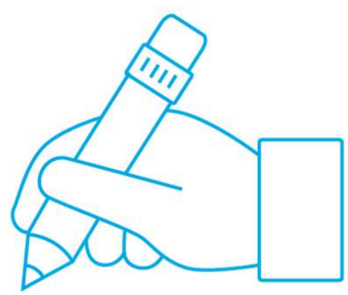
**Filing Deadline**

- Generally, 90 days after the earlier of when the person:
  - enters the transaction
  - becomes contractually obligated to enter the transaction

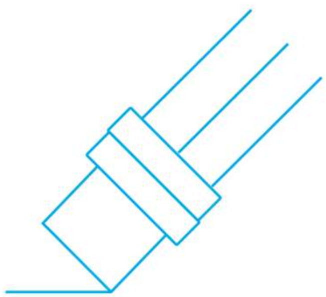
**Penalty (Non-Advisor/Promotor) – Maximum**

Greater of:

- 25% of the tax benefit
- $100,000 or $25,000



# Reportable and notifiable transactions in M&A



**Tax Due Diligence**

- Identify reportable, notifiable, and RUTT
- Assess historical compliance requirements
- Negotiate indemnification provisions to protect against adverse tax consequences
- Understand post-acquisition compliance and reporting requirements

**Share Purchase Agreements (SPA)**

- Representations and Warranties by Sellers re: Mandatory Disclosure Rules
- Undisclosed tax liabilities
- Indemnification

**Potential Flags**

- Requested changes to standard engagement materials
- The tax planning appears to be non-routine, or
- The client’s other advisors recommend reporting

# Reportable uncertain tax treatment

**Definition**

- The tax treatment of the corporation in respect of which uncertainty is reflected in relevant audited financial statements.

**Reporting Corporation**

- Requirement to File Test
- Asset Carrying Value Test
- IFRS/GAAP Test

- **Filing Deadline**
  Applies to all tax years starting after 2022.

- Filing due date is the same as income tax filing deadline

- **Penalties**
  Penalty is equal to $2,000 multiplied by the number of weeks during which the failure continues, up to a maximum of $100,000 (for each uncertain tax treatment).

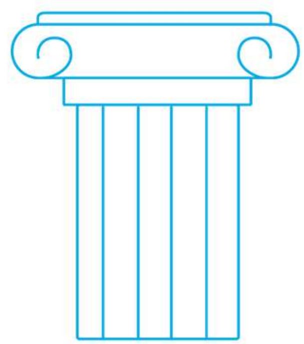
# Summary and practical takeaways

- Three sections
    - Reportable Transactions
    - Notifiable Transactions
    - RUTT
- Substantial monetary and non-monetary penalties for non-compliance
- Communicate with other potential filers to understand who is disclosing and what information they are providing
- New rules mean some guesswork to understand
- Unexpected effects
- Enhanced tax due diligence procedures & additional SPA seller representation and warranties

# General anti-avoidance rule

# GAAR as it exists today

- Government's catch-all
- Three elements must be decided
  - Was there a tax benefit?
  - Was the transaction giving rise to the tax benefit an avoidance transaction?
  - Was the avoidance transaction giving rise to the tax benefit abusive, meaning it cannot be reasonably concluded that the tax benefit obtained was consistent with the object, spirit or purpose of the provisions relied on by the taxpayer?



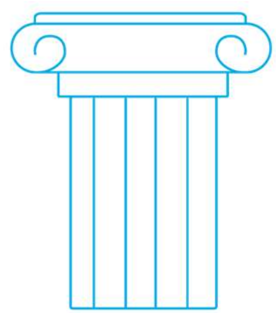
# General anti-avoidance rule

- **Quick Facts**
  - Mentioned in Budget 2022
  - Draft legislation released along with Budget 2023
  - Solicited feedback from the tax community
  - August 4 proposals

- **Amendments**
  - Section 245
    - Preamble
    - Avoidance transaction
    - Economic substance
    - Penalty
  - Subsection 152(4)
    - Reassessment period
- **Effective date**
  - January 1, 2024

## Preamble

- Currently no preamble exists in the GAAR
- Proposed addition would explain that GAAR applies to deny the tax benefit of avoidance transactions that result directly or indirectly either in a misuse or abuse provisions of the Act, while not preventing taxpayers from obtaining tax benefits contemplated by Parliament
- Strikes a balance between:
  - the government of Canada's responsibility to protect the tax base and the fairness of the tax system, and
  - taxpayers' need for certainty in planning their affairs



# Avoidance transaction

- **Current definition**
  - “Primary purpose” test
  - If a transaction or series of transactions was undertaken primarily for bona fide purposes (i.e., legitimate commercial purpose) other than to obtain the tax benefit, then GAAR would not apply, as confirmed in *Canada Trustco Mortgage Co. v Canada*
- **Proposed definition**
  - Expanded definition
  - “One of the main purposes” test
  - Broadens the application so that GAAR will apply if there was abuse regardless if the transaction was commercial or non-tax in nature

# Economic substance

- **Current rules**
  - Do not have an explicit economic substance rule
  - The courts have typically limited the role of economic substance in a GAAR analysis, such that a lack of economic substance in a transaction cannot result in abusive tax avoidance in and of itself
  - **Surplus Stripping**
    - Recent explanatory notes

- **Amendments**
  - Proposing to codify an economic substance rule in GAAR
  - If a transaction or series of transactions is significantly lacking in economic substance, it is presumed to be misuse or abuse
  - Introduces a number of factors that may establish where a transaction or series is significantly lacking in economic substance but it is non-exhaustive

## Penalty

- **Current rules**
  - If a taxpayer is assessed under the GAAR, it does not result in a penalty
  - Simply, the benefit received is vacated
- **Proposed rules**
  - Calculated by a formula which is (taxes payable under GAAR minus tax payable without GAAR) x 25%, less any gross negligence penalties
  - Penalty can typically be avoided if the transaction or series was disclosed under the MDR rules
  - An exception added which states GAAR will not apply where it is reasonable to conclude the taxpayer believed GAAR should not apply due to the transaction being identical or almost identical to a transaction or series that was acceptable by virtue of administrative guidance or jurisprudence

# Reassessment

- Proposing to extend the normal reassessment period under subsection 152(4)
- This means that there will be a three-year extension to the normal reassessment period for GAAR assessments, unless the transaction had been disclosed under the MDR rules
- This rationale is that GAAR transactions are often complex and may be difficult to detect



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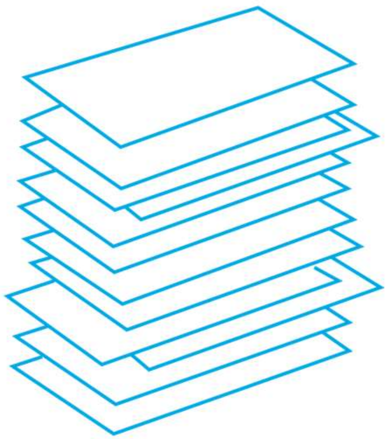
# Impact of GAAR on M&A

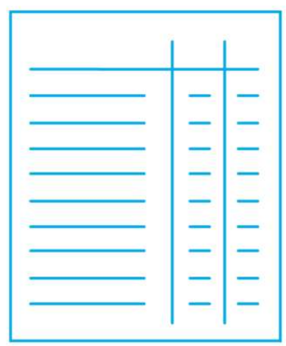


- Increased reporting and caution
- Evaluating tax benefits
- Impact on negotiations
- Impact on deal costs

# Budget 2023 mandatory disclosure rules proposals

# Voluntary reporting mechanism – proposed

- Applies to transactions or series of transactions **not** required to be disclosed as Reportable Transactions
- Due on income tax return deadline
- Can be filed up to a year late



# GAAR relief – proposed

| | Reportable Transaction (Mandatory) | Reportable Transaction (Voluntary – On Time) | Reportable Transaction (Voluntary – Late) | Notifiable Transactions |
|---|---|---|---|---|
| No Penalty | X | X | X | X |
| No Extended Reassessment Period | X | X | | X |
| 1 Year Extended Reassessment Period | | | X | |

# THANK YOU FOR YOUR TIME AND ATTENTION



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# QUESTIONS AND ANSWERS

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