TAX FOR THE Owner-Manager

Editor: Joan E. Jung, Minden Gross LLP, Toronto
(jjung@mindengross.com)

Volume 23, Number 3, July 2023

Bill C-47 and the Interaction Between Adviser Fees and Reportable Transactions

On April 20, 2023, the Department of Finance released Bill C-47 (Budget Implementation Act, 2023, No. 1; royal assent June 22, 2023) and its accompanying explanatory notes. The bill will implement many of the 2023 federal budget measures, and it includes, notably, revisions to the draft legislation regarding the reporting regime for avoidance transactions, which is in section 237.3 of the Income Tax Act (Canada). The changes to this regime were first proposed in the 2021 federal budget, and the relevant draft legislation was released on February 4, 2022 and then on August 9, 2022.

Of particular interest and concern to tax advisers were the revisions to the "hallmark" contained in paragraph (a) of the definition of "reportable transaction" in subsection 237.3(1), which relates to fees charged by advisers and promoters. The February 4 and August 9, 2022 draft legislation proposed significant revisions to that reporting regime, including a reduction in the number of "hallmarks" required to be satisfied to trigger a reporting obligation (from two hallmarks to only one).

The hallmark relating to fees, as currently drafted, encompasses essentially three circumstances. In general and simplified terms, a fee will fall within the ambit of paragraph (a) of the definition of "reportable transaction" if it is a fee that, to any extent, (1) is based on the amount of a tax benefit that results, or would result but for the application of GAAR, from the avoidance transaction or series; (2) is contingent upon the obtaining of a tax benefit that results, or would result but for the application of GAAR, from the avoidance transaction or series; or (3) is attributable to the number of persons who participate in the avoidance transaction or series or who have been provided access to advice or an opinion given by the adviser or promoter regarding the tax consequences from the avoidance transaction or series.

In conjunction with proposing to reduce the number of hallmarks that must be satisfied to trigger a reporting obligation from two to one, the original draft legislation also proposed to lower the threshold for a transaction to be an "avoidance transaction." The proposed amended definition lowers the threshold by substituting the primary purpose test in the current definition for a test based on the standard of whether "one of the main purposes" of the transaction (or of the series of which the transaction is a part) is to obtain a tax benefit. As a result, many advisers were concerned about the broad application of the hallmark relating to adviser fees because virtually any ordinary tax planning would presumably constitute an "avoidance transaction" under this revised definition.

Concerns regarding the proposed mandatory reporting disclosure regime were submitted to the Department of Finance by various parties, including the Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada ("the joint committee") in a submission dated April 5, 2022. The joint committee's submission argued that the broad language regarding adviser fees could capture commercial situations that the joint committee regarded as not being consistent with the goals of the legislation. The broad areas of concern highlighted by the submission were "value billing," contingency work, and fees based on the number of taxpayers participating (an example of which, according to the joint committee, would be a rate given for the bulk preparation of T2057 forms).

Despite these submissions, Bill C-47's only revision to the hallmark relating to fees was the exclusion of a fee in relation to a prescribed form required to be filed under subsection 37(11) (which relates to the SR & ED regime). The explanatory notes accompanying the bill include several comments that appear inspired by the criticisms levelled at the broadness of this hallmark and its potential to capture ordinary commercial arrangements. The explanatory notes provide examples of billing practices that, in the view of the Department of Finance, would not generally be expected to result in a reporting obligation for an adviser, absent additional facts or circumstances that might suggest a different result.

The explanatory notes went on to consider categories of billing that should not create a reporting obligation.

Value Billing

The explanatory notes conclude that a reporting obligation is not expected to arise solely as a result of a fee that is based solely on the value of the services provided in respect of a transaction or series and that is determined without reference to the tax results of the transaction or series. Such billing, in the view of the Department of Finance, would include "value billing" by professionals such as lawyers and accountants, whereby a fee is agreed to at the time of billing and is based on criteria other than the value of the tax benefit resulting from the transaction or series. Factors that would be acceptable to consider in the value-billing arrangement would be the following: the level of training and experience of the persons engaged in the work, the time expended by the persons engaged in the work, the

degree of risk and responsibility that the work entails, the priority and importance of the work to the client, and the value of the work to the client.

Contingency Fees in Respect of Tax Litigation

The explanatory notes also conclude that a reporting obligation is not expected to arise from a contingent litigation fee arrangement in relation to an appeal of a tax assessment in respect of a tax benefit from a transaction or series of transactions. This would be the case, in the view of the Department of Finance, provided that the litigation fee arrangement is implemented after the completion of the transaction or series that is the subject of an appeal. The explanatory notes conclude, however, that a reporting obligation would be expected to arise for a litigator from a contingent litigation fee arrangement that is put in place with a taxpayer, adviser, or promoter in respect of a transaction or series of transactions before the completion of the avoidance transaction or series of transactions.

Fees Collected by Financial Institutions

Finally, the explanatory notes state that, absent other facts to the contrary, the collection of a standard fee (that is, a fee that would generally be charged to the public under normal commercial terms and in comparable circumstances) by a financial institution would not trigger a reporting obligation. Examples of such non-reportable fees include

- fees for the establishment and ongoing administration of a financial account, including where the fee is determined in relation to the amount of the investment;
- a fee offered to a client where the fee is discounted in relation to the number of financial accounts maintained by the financial institution for the particular client; and
- per-transaction charges for each security trade in the context of a year-end tax-loss selling program operated by a financial institution.

The comments on commercial fees came with a caveat:

> [A] reporting obligation would be expected to arise for the financial institution if other facts and circumstances demonstrate that the financial institution is otherwise considered an advisor in respect of the transaction or series, including where the financial institution can reasonably be expected to know that the financial account will be used in a transaction or series that is a reportable transaction to their client.

Fees Based on the Number of Taxpayers Participating

The explanatory notes did not address the question of fees determined in relation to the number of taxpayers participating in the transaction.

How Should Advisers Approach Fees Under the New Regime?

Unfortunately, the inconsistency between the broad language contained in the draft legislation and the Department of Finance's comments in the explanatory notes puts tax advisers in an awkward position. While the Department of Finance's comments will provide some comfort to advisers, it is worth noting that these comments are extrinsic evidence and are not in and of themselves law (although they may be persuasive in the context of tax litigation). Furthermore, in our view, the comments come with various caveats that undermine the comments' persuasive efficacy in the context of future litigation.

Finally, we note that, with respect to fees, any amount can be expressed as a multiple or fraction of any other amount. The Department of Finance's comments that value billing would not trigger a reporting obligation were contingent on the billing not being based on the value of the tax benefit resulting from the transaction. However, most if not all tax planning provides some kind of tax benefit, which may be large in dollar terms regardless of whether it would be regarded as abusive. We leave it to the reader to consider how easy it would be for the CRA to recharacterize a fee as being based in part on the tax benefit if, for example, the fee appears "large," or if hourly rates appear "high." As a practical matter, advisers are left with two options: (1) proactively disclose transactions out of an abundance of caution (despite the fact that the disclosure process can be costly and cumbersome) or (2) apply a pragmatic "smell test" approach and rely on the safe harbours provided in the explanatory notes discussed above. It is likely that the first case to interpret the meaning of these provisions will not be decided for years. In the meantime, uncertainty will be the order of the day as to when an adviser fee triggers a reporting obligation.

Philip Friedlan and Adam Friedlan
Friedlan Law
Richmond Hill, ON
philip.friedlan@friedlanlaw.com
adam.friedlan@friedlanlaw.com