TAX FOR THE Owner-Manager

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Volume 23, Number 4, October 2023

The Mandatory Disclosure Rules: Selected Issues

The revised reporting regime for avoidance transactions ("the reportable transaction rules"), which is in section 237.3 of the ITA, and the new reporting regime for notifiable transactions ("the notifiable transaction rules"), which is in section 237.4—the two regimes are referred to, collectively, as "the mandatory disclosure rules"—took effect on June 22, 2023, when the Budget Implementation Act, 2023, No. 1 received royal assent (Bill C-47). Shortly thereafter, the CRA released guidance ("the guidelines") on these new rules. This article highlights certain issues raised by the mandatory disclosure rules and identifies some of the critical administrative guidance set out in the guidelines.

A comprehensive review of the mandatory disclosure rules is beyond the scope of this article. In very simplified terms, the reportable transaction regime in section 237.3 applies to an "avoidance transaction" (and to each transaction that is part of a series of transactions that includes the avoidance transaction) if any one of three reporting "hallmarks" (that is, "contingent" fee arrangements, confidential protection, or contractual protection) applies to the transaction. The notifiable transaction regime in section 237.4 (again, in very simplified terms) creates a reporting requirement in respect of a "designated" transaction or a transaction in a "designated" series of transactions. Under subsection 237.4(3), the designation is made by the minister of national revenue, with the concurrence of the minister of finance. This reporting requirement also applies to a transaction that is substantially similar to a designated transaction and to a transaction in a series of transactions that is substantially similar to a designated series of transactions. A transaction for which there is a reporting obligation under subsection 237.4(4) of the ITA is a "notifiable transaction."

Reportable and notifiable transactions are reported to the CRA in form RC312.

A Note on the Concept of a "Series"

The mandatory disclosure rules employ the concept of a "series of transactions." Subsection 248(10) provides an expanded notion of series, building on the earlier common-law notion. In very simplified terms, a "common-law series" is understood as a series of transactions, each transaction in the series of which must be preordained to produce a final result.

Subsection 248(10) provides that "[f]or the purposes of this Act, where there is a reference to a series of transactions or events, the series shall be deemed to include any related transactions or events completed in contemplation of the series."

Consequently, the concept of a series of transactions has been interpreted more broadly than the commonsense meaning of the term might imply (see *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63). In particular, the phrase "in contemplation of" in subsection 248(10) has been interpreted to mean "because of" or "in relation to." This means that a series of transactions can be applied both prospectively and retrospectively. Furthermore, although one might think that a series must have a beginning and an end, the SCC in *Copthorne* held that for a transaction to form part of a series, a "strong nexus" is not required, but "more than a 'mere possibility' or a connection with 'an extreme degree of remoteness' " is required. As a consequence of this interpretation, it would be impossible, in some circumstances, to determine the beginning or the end of a particular series.

Straddle Transactions

The reportable transaction rules in section 237.3 require that a reportable transaction be reported in accordance with the deadlines in subsection 237.3(5). These rules apply to reportable transactions entered into after royal assent (that is, after June 22, 2023). The guidelines state, however, that a reporting obligation will also apply to transactions that "straddle" royal assent (for example, a transaction that a taxpayer contracted to enter into prior to June 23, 2023 but entered into after June 22, 2023). For transactions that are part of a series that straddles the date of royal assent, the reporting requirement will be triggered by the first reportable transaction entered into subsequent to royal assent. As stated above, a reportable transaction also includes each transaction that is part of a series of transactions that includes the avoidance transaction. We note that,

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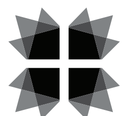
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because of the concept of a "series of transactions," there may be considerable uncertainty regarding whether a transaction "straddles" royal assent.

When Do Notifiable Transactions Become Reportable? What About Transactions Designated After Their Completion?

A reporting obligation is created in respect of a notifiable transaction under subsection 237.4(4) for four classes of persons. The time for complying with that obligation is set out in subsection 237.4(9). For example, a person for whom a tax benefit results, or for whom a tax benefit is expected to result on the basis of the person's tax treatment of the notifiable transaction, will be required to report the transaction to the CRA in the prescribed form within 90 days of the earlier of (1) the day the person becomes contractually obligated to enter into the transaction, and (2) the day the person enters into the transaction. The same deadline applies to an adviser or promoter with respect to a notifiable transaction.

The guidelines do not set out whether there are reporting obligations for a transaction or series of transactions that is completed at the time that the transaction or series, as applicable, is designated as notifiable. Although this issue is not clear, subsection 237.4(1) contains the definition of a "notifiable transaction." The definition is as follows:

> **notifiable transaction**, at any time, means
> (a) a transaction that is the same as, or substantially similar to, a transaction that is designated at that time by the Minister under subsection (3); and
> (b) a transaction in a series of transactions that is the same as, or substantially similar to, a series of transactions that is designated at that time by the Minister under subsection (3).

The reporting requirement in subsection 237.4(4) simply sets out the parties that are required to file an information return.

For a transaction to be a "notifiable transaction" at any time, it must be "a transaction that is the same as, or substantially similar to, a transaction that is designated at that time by the Minister under subsection (3)" or "a transaction in a series of transactions that is the same as, or substantially similar to, a series of transactions that is designated at that time by the Minister under subsection (3)."

The reporting obligation results from the earliest of the triggering events set out in the relevant subparagraph of subsection 237.4(9).

Because a notifiable transaction must be designated "at that time" or be in a series of transactions that has been designated "at that time," a reasonable reading of the provision is that a transaction or series of transactions in respect of which every transaction forming part of the series has occurred prior to the time of designation would not trigger a reporting obligation. What if a series of transactions is not completed before the series is designated by the minister and the relevant transaction occurs before or after the designation? In such a case, there appears to be a reporting obligation. What will the CRA's position be in respect of such reporting obligations (especially in light of the uncertainty regarding when a series begins or ends, as discussed above)? In our view, considering the significant penalties imposed by the notifiable transaction rules, the CRA should explicitly set out in the guidelines its views on these timing issues.

Reporting for Employees and Partnerships

The guidelines state that where a partnership or an employer has received a fee as an adviser or promoter in respect of a reportable transaction and the partnership or employer has reported the transaction as required, it is not also required that the employees of the employer and partners of the partnership report the transaction. (We note that the guidelines are not clear as to whether, in a situation where a partnership advises in respect of a reportable transaction, each partner in the partnership is considered to be an adviser in respect of the transaction.) In the case of the notifiable transaction regime, the guidance notes that employees and partners are deemed to have met their reporting requirement when the employer or partnership has filed the required information return (see subsection 237.4(5)).

Contractual Protection: Carve-Out for Arm's-Length Sale of All or Part of a Business

Contractual protection is one of the three hallmarks that will trigger a reporting obligation under the reportable transaction rules. In clause (a)(ii)(B) of the definition of "contractual protection" in subsection 237.3(1), a carve-out exists for contractual protection that is

> integral to an agreement between persons acting at arm's length for the sale or transfer of all or part of a business (either directly or through the sale or transfer of one or more corporations, partnerships or trusts) where it is reasonable to consider that the insurance or protection (I) is intended to ensure that the purchase price paid under the agreement takes into account any liabilities of the business immediately prior to the sale or transfer, and (II) is obtained primarily for purposes other than to achieve any tax benefit from the transaction or series.

The guidelines set out several examples of contractual protection that, because of this carve-out, will not trigger a reporting obligation. Examples given include standard representations, warranties, and guarantees between a vendor and purchaser; traditional representation and warranties insurance policies; and certain "tax-protection" insurance.

Advisers should note that this legislative safe harbour applies to "persons acting at arm's length"—a phrase not used elsewhere in the ITA. The choice of the word "acting" as opposed to the word "dealing" would appear to include parties deemed non-arm's-length (for example, by virtue of being

"related") who "act" on commercial arm's-length terms. However, the technical notes that accompanied Bill C-47 do not state anything to this effect, and this view, accordingly, is open to doubt.

Conclusion

This article has highlighted only some of the many interpretive issues likely to be raised by the mandatory disclosure rules. Advisers will face very difficult choices when interpretive ambiguities arise. Given the substantial penalties arising from a failure to report and the limited and unclear ambit of due diligence defences available to advisers and other parties, it could be risky to adopt interpretive positions with which the CRA ultimately disagrees. Advisers are faced, accordingly, with either (on one hand) the unenviable task of undertaking onerous and costly reporting in respect of transactions that may not in fact be reportable or (on the other hand) the risk of serious adverse results if an interpretive position is taken that the CRA ultimately disputes.

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