TAX FOR THE Owner-Manager

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

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The Mandatory Disclosure Rules: Selected Issues, Part 2

This article supplements our article in this newsletter's October 2023 issue, regarding the reporting regime commonly known as the mandatory disclosure rules (MDRs). The MDRs encompass two distinct regimes: the reportable transaction rules (in section 237.3 of the ITA) and the notifiable transaction rules (in section 237.4). Our previous article set out a high-level summary of how the MDRs worked, and it highlighted commentary provided in the CRA's guidance ("the guidance"), which was released online and recently updated. This article will comment on several critical changes to the guidance and will highlight certain legal issues raised by the interaction between the MDRs and the guidance. Our coverage of changes to the guidance is not comprehensive, and we survey only a selection of the many changes made.

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

Footnote 2 of the guidance makes clear that the CRA's position is that a reporting obligation will apply in respect of a series of transactions that "straddle" the effective date of designation. The guidance states that

> [i]f a person enters into a series of transactions that straddle the effective date of designation, the reporting requirement will be triggered with the first transaction entered into after the effective date of designation that is part of a series of transactions that is the same as, or substantially similar to one that is designated at that time by the Minister [of National Revenue].

This statement also appears to confirm, by implication, that a reporting obligation will not be triggered in respect of a transaction or a series of transactions in which every transaction forming part of the series has occurred before the time of designation by the minister.

The guidance also states that the effective date of designation of a notifiable transaction will be the date of the designation's posting on the CRA website. (Note that the minister posted designations of notifiable transactions on November 1, 2023.)

General Caveats for the Reportable Transaction Regime

Regarding the hallmarks, the guidance now states that

> [t]he following activities would generally not, in and of themselves, meet a legislative hallmark and, as such, would not result in a transaction being subject to a reporting obligation insofar as the transaction is limited to the circumstances below and no other specific hallmark is met.

This comment is an important qualification and indicates that although the CRA has identified activities that it does not regard as triggering a reporting obligation under the reportable transaction rules, an activity's inclusion in the list hinges on its being a stand-alone item. This qualification gives the CRA considerable wiggle room to argue that a listed activity conducted in slightly different circumstances or in tandem with another activity could nonetheless be regarded as reportable.

It is also worth noting that the guidance uses the term "accountant's liability." This arguably restricts the CRA's position to accountants.

Tax Return Insurance

The guidance now states that the CRA's general view is that tax return insurance would not constitute contractual protection, provided that "the insurance is extended to a taxpayer's filings generally, and does not contemplate any particular transaction or series of transactions entered into by a taxpayer and those who engage in aggressive tax planning would continue to bear potentially significant financial risks associated with such activities." The guidance goes on to state that this type of insurance must not "pay for or reimburse taxpayers for tax imposed as a result of disputed tax positions in respect of aggressive tax planning," and must be subject to a "maximum amount of coverage (or protection) which would not likely cover a material portion of the total expenses incurred by a taxpayer as a result of an audit in respect of aggressive tax planning." It is important to note that the phrase "aggressive tax planning" has no clear parameters. Although most practitioners will welcome this carve-out, a strict reading of the relevant statutory provisions appears to provide little principled basis for it.

Price Adjustment Clauses

The guidance states that "[s]tandard price adjustment clauses, such as those contemplated in Income Tax Folio S4-F3-C1, *Price Adjustment Clauses*, are not considered to meet the contractual protection hallmark," and now also states that "other price adjustment clauses that are not tax-driven (such as a working capital adjustment clause in a Purchase and Sale Agreement) are not considered to meet the contractual protection hallmark."

Former Partners, Former Employees, and Professional Corporation Partners

The earlier versions of the guidance provided (1) that, in respect of the notifiable transaction rules, employees and partners are deemed to have met their reporting requirement when the employer or partnership has filed the required information return(s); and (2) that, in respect of reportable transactions in which 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, the partners and employees would generally not be required to report the transaction. The guidance on reportable transactions now provides that the exclusion for employees and partners now also applies to "in-house tax advisors." In addition, the guidance now states, in respect of both regimes, that the carve-out "also applies to an individual who provides services as an employee of a professional corporation that is a partner of the relevant partnership, directors of a corporation and former employees or former partners." The guidance does not address the situation where a professional corporation provides services but is not a partner of the relevant partnership.

Relying on the Guidance: General Comments

These most recent revisions to the guidance highlight several problematic aspects of the MDRs. Because the MDRs are extremely broadly drafted, they capture transactions that the CRA appears not to want reported.

As initially drafted, the CRA guidance was more or less a restatement of the Department of Finance's technical notes to the MDRs. As the MDRs have been found to apply to a broad range of ordinary commercial situations, the CRA appears to be using the guidance to narrow the ambit of these very broad rules. While the tax profession will welcome this narrowing, caution is in order.

The CRA is not setting out the rationale for many of its positions in the guidance. In our view, many of these positions are clearly administrative concessions not clearly tied to the actual wording in the legislation. This could present difficulties in the future. The most obvious source of difficulty in the future will occur when advisers rely on positions taken in the guidance that are subject to disputes regarding their scope.

In general, the courts have refused to enforce the doctrine of equitable estoppel in tax disputes; this means that the CRA is not bound to adhere to its positions in the guidance. Furthermore, because the guidance is not law, the courts may pay little or no heed to the positions taken by the CRA in the guidance when disputes arise over the MDRs. This is especially likely in situations where the guidance reflects "administration" rather than a restatement of the legislative intent reflected in the Department of Finance's technical notes (which notes are at least extrinsic evidence that is relevant, in some circumstances, to statutory interpretation). We note that the guidance available at the time a series of transactions is entered into may be relevant in determining whether the due diligence defence will be satisfied.

Accordingly, advisers should be very cautious when using the guidance to determine whether a particular transaction or series of transactions triggers a reporting requirement under the MDRs. Advisers should be especially cautious when dealing with parts of the guidance in which the carve-outs are subject to many caveats or whose ambit is not clearly applicable to the scenario faced by the adviser.

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