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Expansion of the Mandatory Disclosure Rules in the Context of Ordinary Commercial and Routine Tax Planning Transactions

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The *Income Tax Act* (Canada) (the "**Act**") has since 2011 included mandatory disclosure rules ("**MDRs**") for certain aggressive tax planning arrangements, and has since 1989 included mandatory identification rules for tax certain shelters.

The technical notes released by the Department of Finance Canada (the "**Department**") on August 27, 2010, with the draft legislation for the then proposed MDRs included the following statements:

> As stated in Budget 2010, the main objective of the proposed reporting regime is to identify to the Canada Revenue Agency certain types of potentially abusive tax avoidance transactions that are not currently subject to any specific information reporting requirements under the Income Tax Act. To preserve the fairness and the integrity of Canada's self-assessment system, the Canada Revenue Agency must be able to properly review tax benefits claimed by taxpayers in their income tax returns, including tax benefits claimed in respect of aggressive tax planning arrangements. On the other hand, a balance must be struck between the need to protect the integrity of the Canadian income tax system and a taxpayer's entitlement to plan their affairs in a manner that legally minimizes their tax liability.[1]

The 2021 Federal Budget announced a public consultation process on proposals to enhance and expand Canada's MDRs, and to address the Canada Revenue Agency's (the "**CRA**") concerns that the existing MDRs were not sufficiently robust to address the lack of timely, comprehensive and relevant information on aggressive tax planning arrangements. The proposed expansion of the MDRs

1 Explanatory (technical) notes in respect of the August 27, 2010 draft legislation implementing remaining 2010 budget measures and other previously announced measures in the income tax act and related acts and regulations: Department of Finance erratum relating to the August 27, 2010 draft legislation (released September 1, 2010).

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was further informed by the recommendations of the Organization for Economic Development and Co-Operation's ("**OECD**") and Group of 20 member countries' ("**G20**") Base Erosion and Profit Shifting ("**BEPS**") project, and specifically the recommendation contained in the Mandatory Disclosure Rules, Action 12: 2015 Final Report published on October 5, 2015 (the "**BEPs MDRs Final Report**")[2].

Canada has been an active participant in the BEPS project of the OECD and G20. The BEPs action plan was launched by the OECD in July, 2013, and included 15 key areas for identifying and curbing aggressive tax planning practices and modernizing the international tax system. The BEPs MDRs Final Report was one or a number of reports released by the OECD in October, 2015, as part of the BEPs action plan. The BEPs MDRs Final Report sets out recommendations for a modular framework for use by countries wishing to implement or amend MDRs in order to obtain early information on aggressive or abusive tax planning schemes and the users and promoters of those schemes. The BEPs MDRs Final Report also sets out recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations.

Following the release of draft legislation and a public consultation process, enhancements to the existing MDRs in section 237.3 of the Act[3] were enacted on June 22, 2023[4] (the "**June 2023 MDRs Enhancements**"). The Department had earlier in April, 2023, published explanatory notes on the enhancements to the MDRs (the "**ENs**")[5]. On July 5, 2023, the CRA published guidance on the enhancements to the MDRs on two webpages, which provide an overview of the MDRs[6], and more detailed guidance on the MDRs[7] (collectively, the "**Guidance**"). The CRA released an update to the Guidance on November 2, 2023. The CRA states in the Guidance that its approach to the application of the MDRs will develop over time based on its experience in dealing with specific factual circumstances.

Although intended to apply to aggressive tax planning arrangements, the first version of the proposed enhancements to the MDRs released in 2022 was sufficiently broad to apply to ordinary commercial and routine tax planning transactions which would not otherwise constitute aggressive tax planning. Following submissions by, among others, The Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada, expressing concern about the breadth of the proposals, the Department added exceptions to the MDRs for certain specific ordinary commercial transactions. The ENs and Guidance, which do not have the force of law, contain further administrative clarification on the application of the enhancements, and examples of ordinary commercial and routine tax planning transactions which the CRA does not consider to be aggressive tax planning, and accordingly exempt from the MDRs. There is no general legislative exception though in the June 2023 MDRs Enhancements for ordinary commercial

2 See https://www.oecd.org/tax/mandatory-disclosure-rules-action-12-2015-final-report-9789264241442-en.htm.
3 All statutory references are to the provisions of the *Income Tax Act* (Canada), unless otherwise stated.
4 See Bill C-47, Budget Implementation Act, 2023, No. 1.
5 See https://fin.canada.ca/drleg-apl/2023/nwmm-amvm-0423-n-eng.html.
6 See https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/mandatory-disclosure-rules-overview.html.
7 See https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/mandatory-disclosure-rules-overview/guidance-document.html, as updated.

and routine tax planning transactions. Accordingly, it will be necessary to review the enhancements to the MDRs, the ENs, the Guidance and any future administrative guidance issued by the CRA to determine whether any particular ordinary commercial or routine tax planning transaction is subject to the MDRs. This article will discuss the MDRs in the context of ordinary commercial and routine tax planning transactions, and will conclude with a recent court challenge to the MDRs brought by the Federation of Law Societies of Canada.

History of the MDRs – Section 237.3

Since 2011, Section 237.3[8] has required that an information return[9] be filed with the Minister of National Revenue (the "**Minister**") in respect of a "reportable transaction"[10], being a transaction that is or is part of a series of transactions[11] that includes an "avoidance transaction" if two of any of the following three hallmarks of aggressive tax planning arrangements applied in respect of the transaction or series:

(a) an "advisor"[12] or a "promoter"[13] or any person who does not deal at arm's length with an advisor or promoter is entitled to a fee in connection with the transaction or series which is contingent on the amount or the obtaining of a "tax benefit"[14] from the transaction or series, or the number of persons who participate in the transaction or series or who receive advice in connection with the transaction or series (the "**contingent fee arrangement**" hallmark);

(b) an advisor or promoter in respect of an avoidance transaction or series, or any person who does not deal at arm's length with the advisor or promoter, obtains "confidential protection" [15] in respect of the transaction or series from, (i) in the case of an advisor, any person who receives advice or assistance from the advisor with respect to the avoidance transaction pursuant to the terms of the advisor's engagement, or (ii) in the case of a promoter, any person to which the avoidance transaction or series is promoted or sold, or from whom consideration is received (the "**confidential protection**" hallmark); and

(c) either, (i) the person (a "**particular person**"), or any other person who entered into the avoidance transaction

8 Enacted by the *Technical Tax Amendments Act, 2012* (S.C. 2013, c. 34), assented to June 26, 2013, for avoidance transactions that are entered into after 2010 or that are part of a series of transactions that began before 2011 and is completed after 2010, with certain grandfathering rules for a series of transactions that began before 2011.

9 On Form RC312.

10 Defined in subsection 237.3(1).

11 The term "series of transactions" has been given an expansive meaning in the case law, and is further extended by subsection 248(10).

12 Defined in subsection 237.3(1), and includes a lawyer or accountant who provides advice, assistance, or contractual protection in respect of the transaction or series of transactions.

13 Defined in subsection 237.3(1).

14 Defined in subsection 237.3(1) as having the meaning assigned by subsection 245(1) for the purposes of the general anti-avoidance rule, that is a reduction, avoidance or deferral of tax or other amount payable under the Act or an increase in a refund of tax or other amount under the Act, including a reduction, avoidance or deferral of tax or other amount that would be payable under the Act but for a tax treaty, or an increase in a refund of tax or other amount under the Act as a result of a tax treaty, or a reduction, increase or preservation of an amount that could at a subsequent time be relevant for the purpose of computing such an amount or result in any of the said effects.

15 Defined in subsection 237.3(1) in respect of a transaction or series of transactions as anything that prohibits the disclosure to any person or to the Minister of the details or structure of the transaction or series under which a tax benefit results, or would result but for section 245, however, the disclaiming or restricting of an advisor's liability is not considered confidential protection if it does not prohibit the disclosure of the details or structure of the transaction or series.

for the benefit of the particular person or any other person who does not deal at arm's length with the particular person or with a person who entered into the avoidance transaction for the benefit of the particular person, has or had "contractual protection" [16] in respect of the avoidance transaction or series, otherwise than as a result of a "contingent fee arrangement", or (ii) an advisor or promoter in respect of the avoidance transaction, or any person who does not deal at arm's length with the advisor or promoter, has or had "contractual protection" in respect of the avoidance transaction or series, otherwise than as a result of a "contingent fee arrangement" (the "**CP**" hallmark).

Prior to June, 2023, "avoidance transaction" was defined in subsection 237.3(1) as having the meaning assigned by subsection 245(3) for the purposes of the general anti-avoidance rule (the "**GAAR**"), that is any transaction on its own or which is part of a series of transactions which transaction or series would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.

The deadline for filing the information return was on or before June 30 of the calendar year following the year in which the transaction became a reportable transaction. The information return was required to be filed by any one[17] of, (i) the person for whom the tax benefit resulted from the reportable transaction or any person who had entered into an avoidance transaction which was a reportable transaction for the benefit of the person, or (ii) every advisor or promoter in respect of the reportable transaction, or any person not dealing at arm's length with the advisor or promoter. A failure to duly file an information return in respect of a reportable transaction that is not the acquisition of a tax shelter nor the issuance of a flow-through share resulted in a penalty under subsections 237.3(8), the GAAR being deemed to apply to the reportable transaction without the misuse/abuse test and the denial of the expected tax benefit from the reportable transaction until the information return in respect of the reportable transaction had been filed and any penalty (whether or not assessed) paid[18], and the extension of the normal reassessment period in respect of the reportable transaction[19].

Subsection 237.3(11) exempts a person otherwise require to file an information return in respect of a reportable transaction from a penalty under subsection 237.3(8) where the person exercised the degree of care, diligence and skill to prevent the failure to file that a reasonably prudent person would have exercised in comparable circumstances.

16 Defined in subsection 237.3(1) in respect of a transaction or series of transactions as:
(a) any form of insurance (other than standard professional liability insurance) or other protection, including an indemnity, compensation or a guarantee that, either immediately or in the future and either absolutely or contingently,
(i) protects a person against a failure of the transaction or series to achieve any tax benefit from the transaction or series, or
(ii) pays for or reimburses any expense, fee, tax, interest, penalty or similar amount that may be incurred by a person in the course of a dispute in respect of a tax benefit from the transaction or series; and
(b) any form of undertaking provided by a promoter, or by any person who does not deal at arm's length with a promoter, that provides, either immediately or in the future and either absolutely or contingently, assistance, directly or indirectly in any manner whatever, to a person in the course of a dispute in respect of a tax benefit from the transaction or series.

17 See former subsection 237.3(4).
18 See subsection 237.3(6).
19 See paragraph 152(4)(b.1), now paragraph 152(4)(b.5).

Under subsection 237.3(17) a lawyer who is an advisor in respect of a reportable transaction is not required to disclose in an information return in respect of the transaction any information in respect of which the lawyer, on reasonable grounds, believes that a client of the lawyer has solicitor-client privilege ("**SCP**").

Tax Shelter Identification Rules – Section 237.1

Under subsection 237.3(14), a "reportable transaction" does not include a transaction that is, or is part of a series of transactions that includes, (a) the acquisition of a "tax shelter" for which an information return has been filed with the Minister under subsection 237.1(7), or (b) the issuance of a flow-through share for which an information return has been filed with the Minister under subsection 66(12.68).

Subsection 237.1(2) requires that a "promoter"[20] in respect of a "tax shelter"[21] must apply to the Minister for an identification number for the tax shelter and no person may sell or issue, or accept consideration in respect of, a tax shelter unless the Minister has previously issued an identification number for the tax shelter[22]. A promoter of a tax shelter must ensure that all persons who acquire or otherwise invest in the tax shelter are provided with the identification number for the tax shelter, must display the tax shelter identification number on the top right-hand corner of any statement of earnings prepared by or on behalf of the promoter in respect of the tax shelter, and must qualify in written statements made by the promoter that the identification number issued by the Minister is for administrative purpose only, and does not confirm the entitlement of an investor in the tax shelter to claim any tax benefit associated with the tax shelter.[23]

June 22, 2023 Enhancements to Section 237.3

The June 2023 MDRs Enhancements to section 237.3 effected the following changes to that section:

(a) replaced the definition of "avoidance transaction" in subsection 237.3(1) so that a transaction will be an avoidance transaction if it may reasonably be considered that one of the main purposes of the transaction, or of a series of transactions of which the transaction is part, is to obtain a tax benefit, and where previously the primary purpose of entering into the transaction or series of transactions must have been to obtain a tax benefit (i.e. the definition of "avoidance transaction" for the purposes of the GAAR);
(b) amended the definition of "reportable transaction" in subsection 237.3(1) by reducing from two to one the number of hallmarks of aggressive tax planning arrangements (i.e. the contingent fee arrangement, confidential protection, and CP hallmarks) required for an "avoidance transaction" to be a reportable transaction;
(c) narrowed the confidential protection and CP hallmarks for the purposes of the definition of the term "reportable transaction" in subsection 237.3(1) to reflect the broadening of the definition of "avoidance transaction";
(d) excepted from the CP hallmark insurance or protection which is integral to an agreement between persons acting at arm's length for the sale or transfer of all or part of a

20 Defined in subsection 237.1(1).
21 Defined in subsection 237.1(1)
22 See subsection 237.1(4).
23 See section 237.1(5).

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

(i) is obtained primarily for purposes other than to achieve any tax benefit from the transaction or series;

(e) introduced the term "tax treatment"[24] of a person to modify the reference to reportable transaction for the purposes of the reporting requirement in subsection 237.3(2);

(f) amended subsection 237.3(5) by reducing the time period in which a person otherwise required to file an information return in respect of a reportable transaction is required to file the return with the Minister[25];

(g) expanded the reporting obligation in respect of reportable transactions to all relevant parties by requiring that any taxpayer receiving a tax benefit from the plan, anyone who has entered into the transaction on behalf of a taxpayer benefiting from the plan, and each advisor or promoter must each file an information return in respect of the same reportable transaction[26];

(h) clarified that the MDRs do not apply to clerical or secretarial services[27];

(i) amended subsection 237.3(8) by expanding the penalties for failing to file an information return when required to do so; and

(j) repealed the definition of "solicitor-client privilege" in subsection 237.3(1), so that the common law meaning of SCP will apply for the purposes of the exception in subsection 237.3(17) to a lawyer's obligation to report a reportable transaction.

The ENs contain the following statement regarding the expansion of the definition of "avoidance transaction":

> This amendment, in conjunction with the amendments to the definition "reportable transaction", are expected to result in an increase in the reporting of reportable transactions. The increase in reporting is aligned with the policy goal of this information reporting regime, which is meant to require the disclosure to the Minister of National Revenue in a timely manner of aggressive tax avoidance transactions. At the same time, it remains important to ensure that the expanded reporting obligations are appropriate to the circumstances and do not result in unnecessary compliance burden.

24 Defined in subsection 237.3(1) as, in respect of a person, a treatment in respect of a transaction, or series of transactions, that the person uses, or plans to use, in a return of income or an information return (or would use in a return of income or an information return if a return of income or an information return were filed) and includes the person's decision not to include a particular amount in a return of income or an information return. The Department in its February 4, 2022, Technical Notes to paragraph 237.3(2)(a) states that the introduction of the term "tax treatment" is intended to ensure that reporting is required in circumstances where a person's filing position is successfully challenged. The term is largely modeled upon the definitions of "tax treatment" and "uncertain tax treatment" in IFRIC Interpretation 23 *Uncertainty Over Tax Treatments* issued in May, 2017, as developed by the International Financial Reporting Standards (IFRS) Interpretations Committee.

25 Now required within 90 days of the earlier of when the taxpayer or anyone on behalf of the taxpayer entered into the transaction or becomes contractually obligated to enter into the transaction.

26 The CRA states in the Guidance that, provided a partnership or employer discloses a reportable transaction as required, its partners or employees would generally not also need to make a disclosure.

27 See subsection 237.3(4).

> Normal commercial transactions that do not pose an increased risk of abuse, in and of themselves, are not intended to result in a reporting obligation under these rules. It is expected that, over time, administrative guidance will be provided by the Canada Revenue Agency to assist taxpayers and tax professionals with the application of these rules.

The enhancements also introduced in new section 237.4 MDRs for "notifiable transactions" entered into after June 22, 2023, defined in subsection 237.4(1) as, (a) a transaction that is the same as, or substantially similar to, a transaction that is designated by the Minister under subsection 237.4(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 by the Minister under subsection 237.4(3).[28]

Finally, the enhancements introduced in new section 237.5 MDRs for "uncertain tax treatment" that is reflected in the financial statements of large corporations.

The ENs and the Guidance contain more information on the new MDRs for "notifiable transactions" and "uncertain tax treatment".

Application of MDRs to Ordinary Commercial and Routine Tax Planning Transactions – The Contractual Protection Hallmark

The expansion of the definition of "avoidance transaction" and the reduction from two to one of the number of the three hallmarks of aggressive tax planning arrangements (again the contingent fee arrangement, confidential protection, and contractual protection hallmarks) required for an avoidance transaction to be a reportable transaction significantly reduced the threshold for a transaction or series of transactions to be a reportable transaction.

A transaction or series of transactions undertaken primarily for bona fide purposes other than to obtain a tax benefit may still be considered an avoidance transaction for the purposes of the reportable transaction rules if one of the main purposes of the transaction or series was to obtain a tax benefit, and notwithstanding that the transaction would not be an avoidance transaction for the purposes of the GAAR. In addition, the presence of the contractual protection ("**CP**") hallmark in a transaction or series of transactions may now on its own result in a transaction being a reportable transaction, where previously one of the contingent fee arrangement or confidential protection hallmarks must also have been present to result in a transaction or series of transactions which is an avoidance transaction being subject to the MDRs. The CP hallmark would generally be present in a transaction or series of transactions where a person receives protection against the failure of a transaction to achieve an intended tax result.

28 The Department in a Backgrounder dated February 4, 2022, identified the following sample notifiable transactions:

(a) manipulating CCPC status to avoid anti-deferral rules applicable to investment income;
(b) creating loss straddle transactions using a partnership;
(c) avoidance of deemed disposition of trust property;
(d) manipulation of bankrupt status to reduce a forgiven amount in respect of a commercial transaction;
(e) reliance on purpose tests in an anti-avoidance rule relating to tax attribute trading restrictions to avoid a deemed acquisition of control; and
(f) using back-to-back arrangements to circumvent the thin capitalization and non-resident withholding tax rules.

On November 1, 2023, the CRA published its list of designated notifiable transactions pursuant to subsection 237.4(3). The wording of the list is identical to the consultation draft published by the Department on February 4, 2022, except that the transactions regarding manipulation of CCPC status have been removed. See https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/mandatory-disclosure-rules-overview/notifiable-transactions-designated-by-minister-national-revenue.html.

Routine Tax Planning Transactions – Avoidance Transactions Lacking Any Hallmarks

Routine tax planning transactions which are avoidance transactions because one of the main purposes of the transaction or series of transactions is to obtain a tax benefit, but which lack any of the contingent fee arrangement, confidential protection or CP hallmarks, are not reportable transactions subject to the MDRs.

The CRA states in the Guidance:

> For greater certainty, there is no legislative reporting obligation under the reportable transaction regime for a transaction or series of transactions where none of the three generic hallmarks - contingent fee arrangements, confidential protection or contractual protection - are present even though it can reasonably be concluded that one of the main purposes of entering into the transaction or series of transactions is to obtain a tax benefit.
>
> For instance, without limiting the foregoing, this could include transactions such as estate freezes, debt restructuring, loss consolidation arrangements, shareholder loan repayments, purification transactions, claiming of the capital gain exemption, divisive reorganizations and foreign exchange swaps. This list is not exhaustive.

Ordinary Commercial Transactions

The June 2023 MDRs Enhancements added a limited statutory exception to the CP hallmark of insurance or protection which is integral to an agreement between persons acting at arm's length for the sale or transfer of all or part of a business where the insurance or protection 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 is obtained primarily for purposes other than to achieve any tax benefit from the transaction or series.

The ENs include the statement that normal commercial transactions that do not pose an increased risk of abuse, in and of themselves, are not intended to result in a reporting obligation under the MDRs. The June 2023 MDRs Enhancements do not though contain a broad statutory exception to the reporting obligation for ordinary commercial transactions which would not generally be considered to constitute aggressive tax planning. It is therefore necessary to look to the MDRs, the Guidance and any future administrative guidance by the CRA to assist in determining whether any particular ordinary commercial transaction or series of transactions is subject to the MDRs because it, (i) is an avoidance transaction because one of the main purposes of the transaction or series is to obtain a tax benefit, and (ii) includes one of the three aggressive tax planning arrangement hallmarks.

The Guidance identifies the following examples of insurance and protection in an ordinary commercial context which, in and of themselves, would not generally satisfy the CP hallmark:

- normal professional liability insurance of a tax practitioner;
- standard representations, warranties and guarantees between a vendor and purchaser, as well as traditional representations and warranties insurance policies, that are generally obtained in the ordinary commercial context of mergers and acquisitions transactions to protect a purchaser from pre-sale liabilities (including tax liabilities);
- standard commercial indemnities

provisions in standard client agreements or documentation, which do not contemplate a specific identified tax benefit or tax treatment;

- contractual protection in the form of insurance that is integral to an agreement between arm's length persons for the sale of a business to ensure the purchase price takes into account any liabilities of the business immediately prior to the sale and the insurance is obtained primarily for purposes other than to obtain a tax benefit from the transaction or series, such as:
  - indemnities related to existing pre-closing tax issues, or the amount of existing tax attributes (tax pools, capital cost allowance, etc.);
  - the availability of a paragraph 88(1)(b) bump of non-depreciable capital property in the course of an acquisition by a public or private company;
  - tax insurance acquired in relation to the purchase of taxable Canadian property from a non-resident of Canada, who could be liable for 25% (or in some cases 50%) of the purchase price for the property pursuant to subsection 116(5) of the Act in the absence of a certificate of compliance issued by the CRA under subsection 116(2) or subsection 116(4) in respect of the disposition;
  - a pre-sale transaction involving the payment of intercorporate dividends to a holding company in order to extract safe income from the target company; and
  - indemnities or covenants to a purchaser and/or target in respect of Part III tax liabilities and other adverse tax consequences arising from dividends paid as part of a pre-closing reorganization;

  however, the above exceptions do not extend to other insurance or protections that may be obtained to cover specific identified tax risks (other than the risks specifically identified in the Guidance), including, for example, through the use of tax liability insurance policies in relation to avoidance transactions, which insurance may often be an indication of aggressive tax planning;
- standard price adjustment clauses, such as those contemplated in Income Tax Folio S4-F3-C1, Price Adjustment Clauses, and other price adjustment clauses that are not tax-driven (such as a working capital adjustment clause in a Purchase and Sale Agreement); and
- an advance income tax ruling from the CRA or other tax administrations on non-Canadian tax issues.

The CRA further states in the Guidance:

> The contractual protection hallmark will not apply in a normal commercial or investment context in which parties deal with each other at arm's length and act prudently, knowledgeably and willingly, and does not extend contractual protection for a tax treatment in respect of an avoidance transaction...

and provides the following examples:

- tax indemnities in standard provisions such as gross-up clauses in loan agreements or International Swap and Derivative Agreements;
- tax indemnities in employment

agreements and severance agreements;
- an indemnity obligation in an RRSP plan document (the "**RRSP Document**") - the terms of which are consistent with standard market practice - whereby the Canadian client who establishes a self-directed RRSP with a Canadian Bank agrees to indemnify the plan trustee in the event that the RRSP plan is subject to tax (the "**Tax Indemnity**"), for example, as a result of holding a non-qualified investment. The CRA states that, while the establishment of an RRSP may constitute an avoidance transaction, the Tax Indemnity is not considered to be contractual protection "in respect of" the avoidance transaction on the basis that this indemnity is a form of protection that applies in the normal commercial or investment context.

Absence of Tax Benefit

"tax benefit" for the purposes of section 237.3 is defined in subsection 237.3(1) as having the meaning assigned in subsection 245(1), that is for the purposes of the GAAR, and means any reduction, avoidance, or deferral of tax, an increase in a refund of tax, or a reduction, increase or preservation of an amount, including a tax attribute, such as paid-up capital, that could at a subsequent time be relevant for the purpose of computing such an amount or result in any of the said effects. Arguably, an ordinary commercial transaction or series of transactions which is not taxable under the Act would not result in a tax benefit. Further, a transaction or series which is taxable under the Act should not result in a tax benefit where the transaction or series does not result in any identifiable reduction, avoidance or deferral of tax, or an increase in a tax attribute.

Finally, a tax benefit may be identified by comparing a transaction or series of transactions with an alternative arrangement that might reasonably have been carried out but for the existence of the tax benefit.[29]

CP Not "in respect of" a Transaction or Series

The Guidance states that insurance and contractual protection will not satisfy the CP hallmark where they are "standard" and obtained or provided in the context of standard client agreements or documentation, or are provided in a normal commercial or investment context between arm's length parties acting prudently, knowledgeably and willingly, and where no specific tax benefit or tax treatment is contemplated.

In one example, the Guidance states in the context of CP in respect of the establishment of an RRSP that the CP will not be "in respect of" the establishment of the RRSP (an avoidance transaction) where "it is a form of protection that applies in the normal commercial or investment context", suggesting that the presence of CP will not be "in respect of" an avoidance transaction which is otherwise an ordinary commercial transaction, and will not result in the transaction being a reportable transaction, where the CP applies in the "normal commercial or investment context".

Challenge to the Constitutionality of a Lawyer's Obligation to Report

As stated above, subsection 237.3(17) exempts a lawyer who is an advisor in respect of a reportable transaction from being required to disclose in an information return in respect of the transaction any information in respect of which the lawyer, on reasonable grounds, believes that a client of the lawyer has SCP.

29 See *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63.

On September 11, 2023, the Federation of Law Societies of Canada, on behalf of all law societies in Canada, including the Law Society of Ontario, filed an application in the Supreme Court of British Columbia challenging under section 7 and 8 of the *Charter of Rights and Freedoms* the constitutionality of the June 2023 MDRs Enhancements, and notwithstanding the exception in subsection 237.3(17), and where the enhancements created a new category of notifiable transactions, and deleted a provision which relieved advisors from the obligation to disclose a reportable transaction which had otherwise been reported by the lawyer's client who was a party to the transaction.

The Federation in a Backgrounder[30] states that it had prior to June, 2023, raised concerns with government officials and before the federal Parliament about the proposals to expand the MDRs. The Federation further states in the Backgrounder that:

> Although exempting legal counsel from the disclosure obligations would not deprive the government of information it needs to combat tax avoidance as it would receive this information from taxpayers, promotors, and other advisors, neither the government nor Parliament addressed the Federation's concerns.
>
> Lawyers and other members of the legal profession, owe a duty of commitment to their client's cause and are also bound by rules of professional conduct to maintain the confidentiality of information received from their clients. These principles are essential to the proper functioning of Canada's justice system. They ensure that individuals receive legal advice informed by full and candid disclosure to their legal counsel that is uninfluenced by counsel's own self-interest. The new provisions, which include significant financial penalties and potential imprisonment for failure to file the required disclosure returns, force legal counsel to choose between their own interests and those of their clients, undermining these important ethical duties and placing legal counsel in an irreconcilable conflict of interest.
>
> The case raises many of the same issues that were at play in the Federation's successful challenge to the application of provisions in the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* and related regulations to members of the legal profession. That case resulted in a 2015 decision from the Supreme Court of Canada *(Canada (Attorney General) v. Federation of Law Societies of Canada*, 2015 SCC) recognizing the duty of commitment to the client's cause as a principle of fundamental justice. The Court held that the legislation violated both section 7 and section 8 of the *Charter* in its operations as against lawyers and was therefore unconstitutional.

The Canadian Bar Association is seeking leave to intervene in Federation's application.

On November 28, 2023, the Supreme Court of British Columbia granted an interlocutory injunction[31] temporarily exempting legal

30 See Federal Challenge of Income Tax Provisions – Backgrounder at https://flsc.ca/wp-content/uploads/2023/09/Challenge-Backgrounder-FE.pdf

31 See https://www.bccourts.ca/jdb-txt/sc/23/20/2023BCSC2068.htm.

professionals from the MDRs pending the determination of the application by the Federation of Law Societies of Canada challenging the constitutionality of the June 2023 MDRs Enhancements. The Court found that the balance of convenience favoured granting such relief.

In its reasons for judgment, the Court held that the Federation met the legal test for the granting of injunctive relief, particularly that at least the following two types of irreparable harm would result if the injunction was not granted:

- if confidential or privileged information is disclosed as a result of legislation that is ultimately found to be unconstitutional, individual clients will be irreparably harmed by the loss of professional secrecy, which cannot be undone, and the prospect of that occurring will have a chilling effect on the ability of individual clients to consult with their lawyers fully and freely pending a final determination of the constitutional challenge; and

- the potential for the unconstitutional reporting of confidential and privileged information, and the conflicts of interest between lawyers and their clients that will arise as a result of potentially unconstitutional legislation, would irrevocably damage the solicitor-client relationship and harm the public interest by undermining the public's confidence in an independent bar.

The Court ruled that the government had not demonstrated any urgency in expanding the scope of the MDRs to make disclosure by legal professionals mandatory.

While the injunction is in effect and pending the determination of the application by the Federation of Law Societies of Canada challenging the constitutionality of the June 2023 MDRs Enhancements, legal professionals will be exempt from the MDRs with respect to reportable transactions and notifiable transactions.

Separately, in November, 2022, the Court of Justice for the European Union held[32] that a provision derived from a European Union Directive[33], which required lawyers to report their involvement in potentially aggressive cross-border tax-planning arrangements (which could lead to tax avoidance and evasion) to competent tax authorities, infringed the right to respect for communications between a lawyer and his or her client, and that the provision be annulled. The provision was similar to the MDRs in section 237.4 relating to notifiable transactions.

Contact Us

If you have a tax and estate planning matter and are in need of legal advice, please do not hesitate to contact **Greg Farano** at 416.865.6787 or via email at gfarano@grllp.com.

(This newsletter is provided for educational purposes only, and does not necessarily reflect the views of Gardiner Roberts LLP.)

32 See the press release issued by the Court at https://curia.europa.eu/jcms/upload/docs/application/pdf/2022-12/cp220198en.pdf.

33 Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC (OJ 2011 L 64, p.1), as amended by Council Directive (EU) 2018/822 of 25 May 2018 (OJ 2018 L 139, p.1).