

2022 TAX DISPUTE RESOLUTION MONTHLY UPDATE

SESSION 6

26 APRIL 2022

LEGAL DISCLAIMER

- Today's session will be a high level overview, for general information purposes, and does not constitute legal advice
- For specific advice relating to the topics discussed today, please contact your legal counsel
- Information in this presentation reflects laws and other relevant standards that are in effect as of the date of the presentation


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DISCUSSION TOPICS

Expanded mandatory disclosure rules for reportable transactions and a new category of notifiable transactions

The Canadian Competent Authority's Advance Pricing Arrangement program

Expert evidence in the Tax Court of Canada, a case study



REPORTABLE AND NOTIFIABLE TRANSACTIONS

MANDATORY DISCLOSURE RULES

- Department of Finance seeking early access to information regarding aggressive tax planning
- Existing reporting rules under the *Income Tax Act* (Canada) not “sufficiently robust” – Budget 2021 announced proposals to enhance mandatory disclosure rules
- Draft legislation released on February 4, 2022 includes:
 1. Changes to existing “reportable transaction” rules
 2. Creation of a new class of “notifiable transactions”
 3. Enhanced penalties for the failure to file an information return for reportable and notifiable transactions

REPORTABLE TRANSACTIONS

- Reportable transaction – “avoidance transaction” having any *one* (existing definition requires two) of the following “hallmarks”:
 1. Contingent fee arrangement
 2. Confidential protection
 3. Contractual protection
- “Avoidance transaction” one of the main purposes is to obtain a tax benefit
 - Lower threshold – currently a primary purpose test

NOTIFIABLE TRANSACTIONS

- Notifiable transactions – designated by Minister of National Revenue (CRA) with concurrence of Minister of Finance
 - Will include transactions CRA considers abusive and transactions CRA identifies to be of interest
 - Includes transactions that are the same as or substantially similar to designated transactions
- Six sample notifiable transactions identified by CRA:
 1. Manipulating CCPC status to avoid anti-deferral rules applicable to investment income
 2. Straddle loss creation transactions using a partnership
 3. Avoidance of deemed disposition of trust property
 4. Manipulation of bankrupt status to reduce a forgiven amount in respect of a commercial obligation
 5. Reliance on purpose test in section 256.1 to avoid deemed acquisition of control
 6. Back-to-back arrangements

INFORMATION RETURNS

- Information returns with respect to reportable and notifiable transactions:
 - due 45 days after the earlier of:
 - the day the taxpayer becomes contractually obligated to enter into the transaction; and
 - the day the taxpayer enters into the transaction
- Must be filed by *each* of the taxpayer and any promoters and advisors – multiple information returns may be required
- Current form RC312 – *Reportable Transaction Information Return* requires a significant amount of information and detail

FAILURE TO REPORT

- Significant penalties for failing to file information return, subject to due diligence defence
 - Taxpayer:
 - \$500 X weeks failure continues to a maximum equal to greater of:
 - \$25,000, and
 - 25% of the tax benefit
 - If a corporation with asset carrying value \geq \$50 million:
 - \$2,000 X weeks failure continues to a maximum equal to greater of:
 - \$100,000, and
 - 25% of the tax benefit
 - Promoter or advisor, total of:
 - Fees charged,
 - \$10,000, and
 - \$1,000 X days failure continues, up to \$100,000

FAILURE TO REPORT

- Tax benefit under a reportable transaction denied under GAAR, without requiring the satisfaction of the misuse or abuse if:
 - The taxpayer failed to file an information return in respect of the transaction;
 - A person is liable to a penalty for such failure; and
 - The penalty has not been paid
- Normal reassessment period does not start until information return is filed

COMING INTO FORCE

- New reporting requirements apply to transactions entered into after 2021
- Penalties will not apply to transactions entered into prior to draft legislation receiving Royal Assent



THE CANADIAN COMPETENT AUTHORITY'S ADVANCE PRICING ARRANGEMENT PROGRAM

CRA'S APA PROGRAM

- Competent Authority Services Division administers APA program
- Transfer pricing transactions (with non-arm's length non-residents)
 - Services, tangible property, intangibles, intercompany loans
- APA provides tax certainty for future years
- Generally applies to 5 future tax years (with possibility of rollback)

CRA'S APA PROGRAM

- Unilateral, bilateral or multilateral APAs
- APA can target specific intercompany transactions
- APA program is voluntary and initiated by taxpayer
- APAs available for certain non-transfer pricing transactions

CRA'S APA PROGRAM

- Annual Reports
- APAs can be amended, cancelled or revoked
 - Material misrepresentation or failure to comply could lead to cancellation or revocation
 - Amended : failure of critical assumption or change in the law (APAs are only amended if taxpayer agrees)
 - Cancelled : effective at beginning of tax year where reason for cancellation arose
 - Revoked : effective retroactively back to beginning of APA term

CRA'S APA PROGRAM

- APA Renewals
 - Same procedure as initial APA submission
 - Renewal process should be quicker than initial submission if no material changes, but often not the case in practice
- APA Considerations
 - Option for taxpayer with history of contentious transfer pricing audits (or potentially contentious future audits)
 - Often a lengthy and costly process, so not recommended for non-contentious transfer pricing transactions



EXPERT EVIDENCE IN THE TAX COURT OF CANADA – A CASE STUDY

EXPERT EVIDENCE IN THE TCC

- **1 General Considerations**
- 2 Case Study
- 3 Practical Considerations

GENERAL CONSIDERATIONS - FRAMEWORK FOR ADMISSIBILITY

- *Voir dire* to determine expert evidence admissibility
- **1** Threshold admissibility
- **2** Gatekeeper function / Residual discretion to exclude

GENERAL CONSIDERATIONS - THRESHOLD ADMISSIBILITY

- **1** Is the evidence logically relevant?
- **2** Is it necessary to assist the trier of fact (enable the Judge to appreciate technical matters in issue – “prescription glasses”)?
- **3** Are there exclusionary rules?
- **4** Is the expert properly qualified?

GENERAL CONSIDERATIONS - GATEKEEPER FUNCTION

- Cost-benefit analysis of the help versus harm of the proposed evidence
- Does the probative value outweigh potential prejudice, confusion and prolonged Court time?
- Once admitted, Judge ultimately decides how much weight to give the expert opinion, considering probative value

GENERAL CONSIDERATIONS - TCC EXPERT WITNESSES

CODE OF CONDUCT

- General Duty to the Court
- **1** An expert witness has an overriding duty to assist the Court impartially on matters relevant to his or her area of expertise.
- **2** This duty overrides any duty to a party to the proceeding, including the person retaining the expert witness. An expert witness must be independent and objective and must not be an advocate for a party.

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CASE STUDY - ISSUES

- Issue was whether the taxpayers, as refugee claimants, were “temporary residents” (under ITA section 122.6) and thereby qualified for the Canada Child Tax Benefit
- Minister determined that refugee claimants were not temporary residents
- Alternate ground for appeal was that the Minister’s determination, even if otherwise legally correct, infringed the appellants’ constitutional rights (*Charter* sections 7 and 15)

CASE STUDY - APPELLANTS' PROPOSED EXPERTS

- Three proposed expert witnesses
- **1** Sociologist
- **2** Psychologist
- **3** Immigration lawyer

CASE STUDY - SOCIOLOGIST AND PSYCHOLOGIST

- Sociologist and psychologist expert evidence admitted
- Social science evidence materially important in *Charter* cases

CASE STUDY - IMMIGRATION LAWYER

- Immigration lawyer expert evidence excluded
- Two parts in proposed expert report
- **1** Legislative history and context concerning various statutes
- **2** Observations on wait times, durations and pathways for refugee determination

CASE STUDY - IMMIGRATION LAWYER

- “Trite law” legal opinion testimony on domestic law inadmissible
- Overall probative value low relative to time and cost for evidence on topics already covered
- “... read like a usual written submission the Court is likely to receive at the conclusion of this trial”
- “... if [she] appears before the Court because of her superlative knowledge in an area of domestic immigration law, she may do so as a lawyer from the lectern beside the counsel table and not as an expert in the witness box”

EXPERT EVIDENCE IN THE TCC

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- 2 Case Study
- **3 Practical Considerations**

PRACTICAL CONSIDERATIONS – TCC EXPERT EVIDENCE

- Settlement negotiations
- Impartial, independent and objective versus advocate or gladiator
- Litigant experts
- Expert on practical operation of regime



**THANK YOU AND
QUESTIONS?**

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