SUBMISSION TO THE DEPARTMENT OF FINANCE AUGUST 9, 2022 DRAFT LEGISLATIVE PROPOSALS

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Submitted electronically at: Consultation-Legislation@fin.gc.ca

MNP LLP (MNP) is pleased to make a submission in response to the Department of Finance (the "Department") request for comments on the draft legislative proposals to the *Income Tax Act* ("ITA" or the "Act") and other legislation released on August 9, 2022 (the "Draft Proposals"). We appreciate the opportunity to provide our comments and recommendations. We note that the comments and recommendations provided in our earlier submission with respect to the Mandatory Reporting Rules and Trust Reporting Rules continue to be relevant.

MNP is a leading national accounting, tax and business consulting firm in Canada. MNP proudly serves and responds to the needs of our clients which include more than 280,000 private enterprise and small and medium sized business clients throughout Canada.

It is important to ensure that certainty and predictability are considered when introducing legislation, particularly when the legislation is intended to impact large groups of taxpayers. Legislation should address its intended objective but cannot do so if the language is ambiguous or subject to varying interpretations. Introductions of new or amended tax legislation should also consider the taxpayers' perspectives; certainty and predictability of requirements on taxpayers must be present for legislation to be understood and for taxpayers to comply.

In our view, some of the language in the Draft Proposals remains ambiguous and continues to cause significant uncertainty for taxpayers and tax professionals alike. It remains unclear how certain proposed rules are to be interpreted by taxpayers and even more unclear as to how they will be applied by the Minister of National Revenue (the "Minister"). Our submission highlights some of the challenges we anticipate our clients will face if the Draft Proposals are enacted without further review and modification.

Specifically, our submission will focus on the following measures:

A. **Reporting Requirements for Trusts**
B. **Mandatory Disclosure Rules**
C. **Small Business Deduction**

A. Reporting Requirements for Trusts

Similar to the legislative proposals released on February 4, 2022 (the "Feb 4 Proposals"), the Draft Proposals significantly expand trust filing and reporting obligations, requiring trusts to file annual returns that were previously exempt, as well as imposing significant additional disclosures. Trusts that were previously exempt from filing, such as those that are inactive, have nominal assets, made no distributions in a year, and had no tax liability in a year, will now be required to file annual returns.

While we are encouraged by the amended language presented in the Draft Proposals impacting trust relationships that are common to the Indigenous community, some concerns remain on the scope of the proposed rules to other trust arrangements.

OUR RECOMMENDATIONS

- Provide an interpretive rule(s) regarding the phrase "the ability to exert influence over trustee decisions" such that these persons can be readily determinable.
- Continue to provide exemptions from annual reporting for trusts with limited activity and/or nominal assets, or at a minimum, consider a *de minimis* rule for reporting similar to that for T1134 filings[1], such that trusts with nominal holdings and/or activity in a year would be exempt from annual reporting requirements.
- Consider simplified reporting whereby the additional required disclosures in proposed Income Tax Regulation ("ITR") subsection 204.2(1) are provided in an initial disclosure (e.g., upon trust creation or with the application for a trust account number) and then only in future periods where there are changes to that information.
- Simplify the disclosure requirements in proposed ITR subsection 204.2(1) by narrowing the definition of "settlor" [the definition in ITA subsection 17(15) being used for this purpose is broader than the commonly understood concept of settlor].

Bare Trusts

As noted in our submission on the Feb 4 Proposals (referred to herein as the "Prior Submission")[2], the extension of the trust filing and reporting obligations to "bare trusts" through proposed ITA subsection 150(1.3) creates redundancy in reporting and will be a significant compliance burden for impacted parties. Income or loss from the property in bare trust arrangements is typically reported by the beneficial owners in their tax returns. Information on trustees in bare trust arrangements that is required to be disclosed in proposed ITR subsection 204.2(1) will likely be available to the Minister from other sources. For example, corporate trustees (nominees) in bare trust arrangements involving real estate are required to file *T2 Corporation Income Tax Returns* annually.

There is uncertainty as to how the proposed rules will be applied to informal, or even unintentional, bare trust family arrangements, or even what benefit these filings could provide the Minister. In our view, there will be widespread confusion on this issue and greater clarification is needed. For example, the term "bare trust" is generally considered to exist where there is a separation between legal and beneficial owners. Are only bare trust relationships involving trusts subject to the new reporting requirements, or is it to be interpreted on the

[1] For purposes of completing Form T1134, detailed supplemental information is not required for "dormant" or "inactive" foreign affiliates. A "dormant" or "inactive" foreign affiliate means, for a taxation year of the foreign affiliate, one that had gross receipts of less than CAN$100,000 in the year and at no time in the year had assets with a total fair market value of more than CAN$1,000,000.

[2] MNP Submission to the Department of Finance on the February 4, 2022 Draft Legislative Proposals, dated April 4, 2022.

broader aspect as applying to all bare trust relationships? Does this term also extend to cost-sharing arrangements that many professionals across Canada utilize for paying expenses with pooled funds?

Our recommendation at this time is for the Minister to provide clarification on the specific areas of concern that these reporting requirements are intended to address. Doing so would allow the public, including taxpayers and professional advisors, to consult and collaborate with the Minister on developing a practical approach to collect this information. For example, if the Minister is seeking information on real property holdings or transactions, this information can be provided with assistance or directly from sources that have already collected this information, such as provincial land and personal property registries.

OUR RECOMMENDATIONS

- Eliminate proposed ITA subsection 150(1.3) in respect of bare trust arrangements or consider alternative reporting methods such as a one-time disclosure.
- Confirm if the proposed rules are expected to extend to cost-sharing arrangements and if so, consider a carve out as an exception.

Effective Date of Proposed Reporting Requirements

The Draft Proposals will apply the new reporting requirements to all trusts with taxation years ending after December 30, 2022. This does not appear to be a practical approach to implement the new rules. Consider trusts created many years ago that have been exempt from annual trust return filings due to having no income and no distributions to beneficiaries. They will now be required to file annual returns and disclosures, even though they will likely continue to remain inactive until they are wound up, at which time we acknowledge a return would be required to be filed. Until that time, the information provided in the required annual filings will be of little to no value to the Minister, as there is no activity to report. We strongly urge the Department to instead apply the proposed reporting rules on a prospective basis, for new trusts settled on or after January 1, 2022, where the required information will be readily available. At a minimum, the effective date for the new reporting requirements should be deferred to taxation years ending after December 30, 2023 given that, as of the current date, the Minister has not published details on the specific information to be reported.

OUR RECOMMENDATION

Apply the proposed reporting rules on a prospective basis (e.g., for new trusts settled on or after the date of royal assent.

Penalties

As noted in our Prior Submission, the penalties proposed in ITA subsection 163(6) for a false statement, omission, or failure to file a return due to gross negligence appear to be excessively punitive. For consistency, we encourage the Minister to revisit these proposals to better align the penalties to those of other information reporting measures in the Act, such as for foreign reporting.

Furthermore, it is our view that administrative penalty relief should be available in at least the first few years the new rules are in effect, given the expected challenges of compiling historical records to meet the new information disclosure requirements.

OUR RECOMMENDATIONS

- Apply the proposed penalty rules on a prospective basis (e.g., for new trusts settled on or after the date of royal assent).
- Align the gross negligence penalty structure to those of other information reporting measures in the Act.
- Introduce a due diligence exception from penalties where the taxpayer makes reasonable efforts and discloses what information is unavailable.

B. Mandatory Disclosure Rules

Definition of "Reportable Transaction"

As previously noted, the amended definition of "reportable transaction" in ITA subsection 237.3(1) provides that only one of three hallmarks need be present to cause a transaction to be reportable. We remain concerned that the broad language in this definition may encompass many common and allowable *bona fide* commercial tax transactions. For example, it is common practice for a vendor in a share sale transaction to provide representations and indemnity clauses regarding the tax attributes of its target corporations. In addition, sale transactions often require temporary non-disclosure agreements between parties until a sale is reached and could contain certain terms that could arguably cause them to create confidential protection (as defined in ITA subsection 237.3(1)), which could then create a reporting obligation.

The generality of the Draft Proposals appears to also require disclosure on transactions that arguably would be of little value to the Minister. For example, on a strict reading of the Draft Proposals, it appears that advisory services provided in respect of a simple claim for investment tax credits under the Scientific Research and Experimental Development program (SR&ED) could be considered a "reportable transaction" and subject to the reporting requirements in amended ITA section 237.3 where such services are provided on a contingent fee basis[3]. Without further clarification on how the "reportable transaction" definition is to be interpreted, the existing uncertainty in the Draft Proposals can result in taxpayers and advisors being subject to unnecessary, costly and unintended reporting obligations on *bona fide* transactions.

OUR RECOMMENDATIONS

- Further clarify the proposed rules - if the intended outcome is to increase meaningful disclosure, more specificity is required.

[3] It is a common practice for professional advisors assisting with the preparation of SR&ED claims to be compensated (in part or in full) based on the successful outcome of the claim.

- Amend legislation - if the intended outcome is to identify aggressive tax strategies or eliminate specific tax planning that is currently allowed under the legislation, then specific amendments to the legislation should be made.
- Narrow the application of the legislation with respect to reportable transactions to those entered into on or after the date of royal assent to be consistent with the proposed application of penalties.
- Apply the use of a *de minimis* test or other measure to reduce the potential administrative burden; consider for example the thresholds for the T106 filing[4], particularly for smaller businesses/taxpayers.

Definition of "Notifiable Transaction"

As noted in our Prior Submission, the proposals indicate that disclosure for a notifiable transaction will be required in respect of a transaction that is *substantially similar* to a transaction or a series of transactions designated by the Minister (ITA subsection 237.4(1)), and that term is to be interpreted broadly in favour of disclosure (ITA paragraph 237.4(2)(b)). The objective of the mandatory disclosure rules is to ensure disclosure of aggressive tax planning; the legislation as drafted lacks clarity and leaves open the potential for the rules to be applied in situations beyond the intended scope. Pursuant to proposed ITA subsection 237.4(3), the Minister may designate transactions or series of transactions in such a manner as the Minister considers appropriate; it is unclear on how much advance notice the Minister would be required to provide in respect of any such designations as the definition of "notifiable transaction" in proposed subsection 237.4(1) simply refers to "at that time". This effectively removes the rules from legislative or Parliamentary oversight, as it provides the possibility for other transactions to be designated as requiring disclosure without having those transactions first discussed in Parliament, included in the ITA and objectively tested in the tax courts.

Taxpayers have the right to have the law applied consistently; they should therefore have the right to a clear understanding of what is reportable or notifiable and what is not. If the reporting requirements are not clear, this will lead to useless and needless over-reporting. Some taxpayers may not have the resources of larger, more sophisticated taxpayers and may be unfairly disadvantaged in navigating these complex interpretive rules without significant and comprehensive guidance from the Minister.

OUR RECOMMENDATIONS

- Narrow the application of the legislation with respect to notifiable transactions to those entered into on or after the date of royal assent to be consistent with the proposed application of penalties.
- Identify and codify specific transactions that are not open to interpretation by different parties rather than using subjective terms such as "substantially similar". The Minister should provide additional interpretation on this term – guidance that provides more practical information. For example, clarify if it is the result achieved by the transaction, or how the result is achieved that will create a reporting obligation.

[4] T106 Information Return of Non-Arm's Length Transactions with Non-Residents - for tax years or fiscal periods that begin in 2022 and later, where the amount of the transactions with a particular non-resident during the tax year or fiscal period is below CAN$100,000, there is no need to report these transactions.

- Apply the use of a *de minimis* test or other measure to reduce the potential administrative burden; consider for example the thresholds for the T106 filing[1], particularly for smaller businesses/taxpayers.
- The determination of what is notifiable should not be left to the Minister's sole discretion.

Reporting Timeline

The 45-day deadline outlined in proposed ITA subsections 237.3(5) and 237.4(5) for the required disclosure for reportable and notifiable transactions remains problematic for the parties involved given the level of information required to be disclosed. The usefulness of the disclosed information within this timeframe is questionable. Additional certainty is required with respect to when the timeframe starts and when a taxpayer is considered contractually obligated to enter into a transaction. Negotiations for complex transactions can extend for months after letters of intent are signed.

If the Minister is seeking additional information on specific transactions, it is likely that these information returns will not be reviewed in practice until the related tax returns are filed by the taxpayers involved. Accordingly, the information should only be required to be provided as part of the regular tax compliance process and be subject to the same filing deadlines. If the purpose of the proposals is to streamline the work of the Minister, the proposed rules will likely have the opposite effect.

OUR RECOMMENDATION

Extend the deadline for disclosing reportable and notifiable transactions from 45 days to the due date of the tax return.

Parties Subject to Reporting Under the Mandatory Disclosure Rules

Pursuant to the Draft Proposals, particularly for reportable transactions, reporting by one party will no longer discharge another person's obligation to report. Currently, ITA subsection 237.3(4) states that "if any person is required to file an information return in respect of a reportable transaction under that subsection, the filing by any such person of an information return with full and accurate disclosure in prescribed form in respect of the transaction is deemed to have been made by each person to whom subsection (2) applies in respect of the transaction."

The filing of income tax and information returns are ultimately the responsibility of the taxpayers; the reporting required under the mandatory disclosure rules should be the same, such that the taxpayers involved – and not their advisors or representatives – in what is determined to be a reportable transaction or notifiable transaction are responsible for the required reporting. Multiple filings are unnecessary and create undue burden on both taxpayers and their representatives. Consider the example of a corporation owned by seven shareholders. Where the corporation is involved in a reportable transaction or a notifiable transaction, it appears the Draft Proposals could, in some situations, mandate reporting to disclose the transaction from the corporation as well as each of the seven shareholders. For income tax purposes, the corporation would be responsible for its annual reporting on behalf of all shareholders – the same should hold true in respect of the mandatory disclosure rules. In our view, there is little benefit to the redundant reporting, as it increases taxpayer compliance costs, increases the volume of information processing required by the Minister, and can also cause uncertainty and confusion on processing where involved parties submit variations of the information disclosed.

OUR RECOMMENDATION

Eliminate the proposed multi-party disclosure requirement for the same transaction or series and maintain the current system of a single reporter.

Proposed ITA subsection 237.4(5) for notifiable transactions states that "for the purpose of subsection [237.4](4), if any person is required to file an information return in respect of a particular notifiable transaction under paragraph (c) or (d) of that subsection, the filing of an information return by an employer, or a partnership, in respect of the notifiable transaction under that subsection in prescribed form and manner in respect of the transaction is deemed to have been made by each employee of the employer, or each partner of the partnership, to whom subsection (4) applies in respect of the particular transaction." While this is a welcome addition to the proposed rules from the Feb 4 Proposals, consideration should be given to extending these measures to apply in respect of reportable transactions.

OUR OTHER RECOMMENDATIONS

- Eliminate the redundant reporting proposed for uncertain tax positions; the Minister can look to developing improved capability to analyze this information from the current information collection systems already in place.
- Revise the penalty structure so tax advisors are penalized only if they did not properly advise the taxpayer of their requirement to file the required information returns. Advisors should be able to demonstrate due diligence that they advised taxpayers on the reporting requirements and substantiate if it was determined that the reporting was not required.

C. Small Business Deduction

While the proposed increase to the upper threshold of taxable capital from $15 million to $50 million with respect to calculating the small business limit for corporations in ITA paragraph 125(5.1)(a) is a welcome change, we are of the view that the lower threshold of $10 million should also be increased to an amount commensurate with the economic realities of today's business world. Applying the average annual rate of inflation between 1994, when the business limit phase-out was introduced, and 2022 of 2.08%, $10 million in 1994 is over $17.5 million[5] in today's dollars. Covid-19 greatly impacted many taxpayers, requiring some to take on unprecedented levels of debt and this directly impacts their taxable capital.

[5] Bank of Canada inflation calculator - https://www.bankofcanada.ca/rates/related/inflation-calculator/

What really is a "small business"? This has different connotations and different economies of scale across various industries. Some businesses are far more capital intensive than others, for example, residential home construction and farming. Total farm debt has risen over 440% from 1990 to 2021, according to Statistics Canada,[6] yet tax benchmarks and deduction limitations have not increased at all to match this economic reality. This will only increase as our farmers are asked to drastically decrease their greenhouse gas emissions and carbon footprint to meet Canada's targets, which will require large investments in new technologies and other assets requiring financing. In our view, the lower limit of taxable capital that impacts the ability of Canadian corporations to access the small business rate is far overdue for an increase. We are also of the view that the threshold for passive income impacting the small business limit should be indexed to account for inflation. As Canadians continue to face rising interest rates, inflation and the elimination of pandemic relief programs, it will likely be necessary for many businesses to save any excess funds as financial cushions for the future. Those businesses who choose to self-fund rather than borrow should not be penalized with a limitation on their access to the small business tax rate. Instituting indexed increases to the $50,000 annual limit for passive income in an associated group of companies would be a welcome relief for many Canadian businesses.

OUR RECOMMENDATIONS

- Increase the lower threshold of taxable capital in ITA paragraph 125(5.1)(a) from $10 million to a minimum of $20 million to account for inflation and consider indexing the limits annually.
- Link and index the passive income reduction on the business limit to inflation.

CONCLUSION

Based on the issues noted above, the measures introduced in the Draft Proposals will, in our view, create significant confusion and uncertainty as to how they are to apply. We request that consideration be given to each of the recommendations discussed above. We are concerned with the broad assessment authority the Draft Proposals appear to grant the Minister and strongly urge that amendments are undertaken to provide clarity to allow for the consistent application of the legislation. Provisions that allow for punitive measures including penalties and costs must also provide a level of certainty and predictability for taxpayers to remain compliant.

MNP is pleased to continue to work with the Government, other members of Parliament and policy makers across Canada to further discuss our observations, comments and recommendations in this submission.

[6] Statistics Canada. Table 32-10-0051-01 Farm Debt Outstanding, classified by lender (x 1,000).