CHARTERED PROFESSIONAL ACCOUNTANTS CANADA
COMPTABLES PROFESSIONNELS AGRÉÉS CANADA

Chartered Professional Accountants of Canada
277 Wellington Street West Toronto ON CANADA M5V 3H2
T. 416 977.3222 F. 416 977.8585
www.cpacanada.ca

Comptables professionnels agréés du Canada
277, rue Wellington Ouest Toronto (ON) CANADA M5V 3H2
T. 416 977.3222 Téléc. 416 977.8585
www.cpacanada.ca

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Trevor McGowan
Director General
Tax Legislation Division
Tax Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa, ON K1A 0G5

Email: Consultation-Legislation@fin.gc.ca

Dear Mr. McGowan:

Subject: Uncertain Tax Treatments ("UTT Proposals")

This submission sets out Chartered Professional Accountants of Canada's comments and recommendations on the Draft Legislation released on February 4, 2022 relating to Uncertain Tax Treatments ("UTT Proposals"). It should be noted that the Joint Committee on Taxation of The Canadian Bar Association and Chartered Professional Accountants of Canada will be making a separate submission on the proposed measures on reportable transactions and notifiable transactions.

As always, we hope our comments are useful and will be considered. We would be pleased to discuss our comments in more detail and answer any questions you may have.

Yours truly,

Bruce Ball, FCPA, FCA, CFP
CPA Canada, Vice President, Taxation
Tel: 416-204-3935
Email: bball@cpacanada.ca

Reportable Uncertain Tax Treatments

Introduction

This submission sets out our comments and recommendations on the Draft Legislation released on February 4, 2022 relating to uncertain tax treatments ("UTT Proposals"). It should be noted that the Joint Committee on Taxation of The Canadian Bar Association and Chartered Professional Accountants of Canada (the "Joint Committee") will be making a separate submission on the proposed measures on reportable transactions and notifiable transactions.

On March 30, 2017, the Federal Court of Appeal (FCA) rendered its decision in *BP Canada Energy Company v. Canada (National Revenue)*,[1] allowing BP Canada's appeal and reversing the Federal Court's decision. BP Canada was appealing the Federal Court's June 5, 2015 decision in which the Court authorized the Minister's access to certain of BP Canada's Tax Accrual Working Papers (TAWPs). These are internal accounting documents prepared by public corporations for financial reporting purposes. TAWPs typically reveal uncertain tax positions taken by public corporations in filing their tax returns, and they may contain opinions as to the likely outcome should the Minister challenge a position. TAWPs also provide for the establishment of reserves to ensure sound and fair financial reporting.

Given the potential impact of this judgment on the broader public interest, Chartered Professional Accountants of Canada (CPA Canada) sought and obtained intervener status before the FCA. In making representations before the court on February 21, 2017, CPA Canada took no position on the merits of the case or the arguments of the parties involved. Rather, CPA Canada intervened to ensure that relevant facts and arguments were considered when the court was making decisions that affect the profession and its mandate to act in the public interest. In the Memorandum of Fact and Law filed with the Court (the "Memorandum"), we highlighted the importance of achieving an appropriate balance between:

(a) The legitimate exercise of the Canada Revenue Agency's (CRA's) audit powers pursuant to which it should be entitled to obtain objective information;
(b) The need for complete disclosure of tax risks by corporations to their external auditors in the context of their financial reporting obligations so that auditors can fulfil their responsibilities in the interest of the Canadian public; and
(c) The legitimate expectation that subjective information is not information that ordinarily relates to or may relate to the type of information required pursuant to section 231.1 of the Income Tax Act (the "Act").

As summarized in the Memorandum, our primary concern was the order of the Federal Court could be used to obtain subjective information from taxpayers and CPAs alike. From a public interest standpoint,

[1] 2017 FCA 61.

the complete discoverability of tax accrual working papers and the subjective tax risks they account for can only negatively affect the efficient functioning of the capital markets and interfere with legitimate business transactions. Simply put, the possibility that the CRA could access subjective opinions on tax risks without any safeguards may discourage corporations from preparing such analyses in order to protect it from disclosure.

In the Memorandum, CPA Canada submitted that one approach that might be taken to foster compliance both with section 231.1 and the above guiding principles would be through the disclosure of all transactions that could have a material impact on the corporation's tax liability, without identifying the degree of tax risk that any of those transactions may have. That is, a "List of Material Transactions." As part of the suggestion, we also made it clear that to be consistent with rules of public order, there should be no requirement for disclosure to the CRA of subjective risk assessment, through the disclosure of the issues list or otherwise.

The UTT Proposals are not consistent with the approach that we suggested in the Memorandum as reporting corporations will be required to disclose details on the uncertain tax treatments recorded on the relevant financial statements. This means that they will be required to report the specific issues that they believe should be recorded after performing a subjective risk assessment. Although proposed subsection 237.5(7) states that the filing of an information return under proposed subsection 237.5(2) of the Act in respect of a reportable uncertain tax treatment is not an admission by the taxpayer that the tax treatment is not in accordance with the law, we are still concerned that such a disclosure will be seen by the CRA as a self-determined "soft spot" and will be dealt with as such.

Therefore, for the reasons laid out in the Memorandum, we are concerned that the introduction of these proposals may undermine the complete disclosure of tax risks by corporations to their external auditors in the context of their financial reporting obligations, resulting in auditors not being able to fulfil their responsibilities in the interest of the Canadian public.

Beyond identifying the uncertain tax treatments, the rules must be clear that there will be no additional requirement to disclose subjective information such as the rationale used to determine that the issue should be treated as uncertain. Provided that the required factual information has been disclosed, there should be no need for this information.

> ***Recommendations –*** We believe that the proposed reporting rules can have a negative impact on how corporations deal with their external auditors, which may give rise to financial reporting concerns. We believe that other methods can be employed that will provide the CRA with additional relevant information and these should be investigated.

Failing that, the proposed legislation should clearly indicate that the reporting requirements for each uncertain tax position can be met by providing factual information only and reporting corporations will not be required to provide subjective tax information beyond identifying the individual uncertain tax treatments. Due to the importance of the financial reporting system for the Canadian public, we believe that this should be incorporated in the legislation and not left to administrative policies that that the CRA can apply on a discretionary basis.

In the balance of this submission, we provide our more specific feedback to the provisions of the UTT proposals. The key sources referenced in this submission include the UTT Proposals, the Explanatory Notes on the Legislative Proposals Relating to Income Tax Act and Other Legislation released on February 4, 2022 ("the Explanatory Notes"), and the Mandatory Disclosure Rules – Backgrounder released on February 4, 2022 ("the Backgrounder").

Specific Considerations Related to the Draft Legislation

Uncertainty on scope of "reportable uncertain tax treatment"

A "reportable uncertain tax treatment", of a reporting corporation for a taxation year is defined in proposed subsection 237.5(1) of the Act as "a tax treatment of the corporation in respect of which uncertainty is reflected in relevant financial statements of the corporation for the year".

Furthermore, proposed subsection 237.5(1) of the Act defines "tax treatment", of a corporation as "a treatment in respect of a transaction, or series of transactions, that the corporation 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 corporation's decision not to include a particular amount in a return of income or an information return".

There are several issues that were identified on the scope of a reportable uncertain tax treatment that we want to comment on:

a) Canadian income tax issues only should be reportable

The rules generally appear to apply to uncertain amount related to income tax (i.e. reference to a requirement to file an income tax return under section 150, the rules are contained in the Income Tax Act, and the nature of references/examples in the Explanatory Notes and the Backgrounder).

However, the definition of "reportable uncertain tax treatment" refers to tax generally. And the definition of "tax treatment" is also not specific (many types of taxes may have an impact on the income tax return

although most likely indirectly). Consequently, it is not clear how taxes other than Canadian income taxes enter into the reporting requirement.

Take for example a situation where a Canadian company has uncertainty on a tax position, but the underlying issue relates to a jurisdiction outside of Canada. The uncertain tax treatment is reflected in Canada in the relevant financial statements and may have an indirect impact on the Canadian tax return. Under the proposals as drafted, it is not clear whether this uncertainty would need to be disclosed even though it is a non-Canadian tax issue.

Concerns were also identified where uncertain tax treatments are reflected in consolidated financial statements for a world-wide group. As currently drafted, it appears the reporting requirement could be read as requiring the reporting of world-wide uncertain tax treatments to the CRA.

> ***Recommendation*** - The proposed definition of "reportable uncertain tax treatment" should be adjusted to make it clear that a reporting requirement applies only to Canadian income tax issues for which uncertainty is reflected in the relevant financial statements.

b) Uncertain tax treatments not captured under IFRIC 23

In the commentary on the definition of "reportable uncertain tax treatment" and "tax treatment" in the Explanatory Notes, Finance Canada has indicated "that the meaning of tax treatment is largely modeled upon the definitions 'tax treatment' and 'uncertain tax treatment' in IFRIC Interpretation 23, as developed by the IFRS Interpretations Committee ('IFRIC 23')". Furthermore, in an example cited by Finance Canada on whether uncertainty would be considered to be reflected in financial statements prepared in accordance with U.S. GAAP, reference is made to Accounting Standards Codification (ASC) 740 (Income Taxes).

Finance Canada does not, in its commentary on the definition of "reportable uncertain tax treatment" and "tax treatment", refer to uncertain liabilities that would not fall within the scope of IFRIC 23 and ASC 740. For example, provisions and contingent liabilities that would have been recorded in a corporation's relevant financial statements under IAS 37 Provisions, Contingent Liabilities and Contingent Assets under International Financial Reporting Standards or ASC 450 Contingencies under U.S. GAAP are not referred to. It should be noted that IFRIC 23 indicates that the interpretation is to be applied to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12.

Based on this, it is unclear whether a "reportable uncertain tax treatment" only includes an uncertainty reported in a corporation's relevant financial statements as an uncertain tax treatment under its

applicable reporting standards or whether it also includes any other reserves recorded in a corporation's relevant financial statements that relate to rules contained in the Act.

As an example, IAS 12 and the corresponding US GAAP rules are narrowly applied to *income* tax issues only and this does not always correspond to the Income Tax Act meaning of that term. It is possible that a company may conclude a certain tax issue that is not an income tax issue (e.g., Part XIII tax issues, Part VI tax issues etc.) and therefore not reported as an uncertain tax treatment under IAS 12 but rather as a contingency under IAS 37. A company could therefore face uncertainty over whether there is a need to report it or be subject to penalties or the statute of limitations exception if they do not.

> ***Recommendation –*** The proposed legislation should clarify whether a "reportable uncertain tax treatment" only includes an uncertainty reported in a corporation's relevant financial statements as an uncertain tax treatment under its applicable reporting standards or whether it also includes any additional reserves recorded in a corporation's relevant financial statements with respect to a position on a tax return related to rules in the Act.

c) Government assistance

In the proposals or explanatory notes, Finance Canada does not refer to government assistance received that would be recorded in a corporation's financial statements under IAS 20 Accounting for Government Grants and Disclosure of Government Assistance.

Government grants, including non-monetary grants at fair value governed by IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, shall not be recognised until there is reasonable assurance that the entity will comply with the conditions attaching to them and the grants will be received.

Under what circumstances, if any, would a corporation have an obligation to report an uncertain tax treatment with respect to a tax credit that falls under the scope of IAS 20? For example, if an amount of a tax credit governed by the Act claimed in an income tax return is greater than the amount recorded in audited financial statements under IAS 20, as a result of an uncertainty related to the conditions attached to the tax credits, would such an excess represent a "reportable uncertain tax treatment" for purposes of proposed subsection 237.5(1)?

> ***Recommendation –*** Finance Canada should clarify whether a corporation has an obligation to report an uncertain tax treatment with respect to a tax credit governed by the Act that falls under the scope of IAS 20 and the full amount claimed is not reflected in the relevant financial statements.

Consolidated financial statements and reporting requirements

The definition of "reportable uncertain tax treatment" refers to a tax treatment of the corporation in respect of which uncertainty is reflected in relevant financial statements of the corporation for the year. The relevant financial statements are either those for the corporation alone or the consolidated statements for the group in which the corporation is part of depending on the circumstances.

In the definition of "tax treatment", reference is made only to the corporation's own tax return.

The presumption seems to be that each corporation in the consolidated group must report its own reportable uncertain tax treatments although reference is made to the same set of consolidated statements for each member of the group.

> ***Recommendation –*** For greater certainty, confirmation should be provided that reporting is required only for issues reflected in the consolidated financial statements by the specific corporations affected and not by every member of the consolidated group. If the specific issue does not impact certain corporations in the consolidated group, then they do not have to report.

Corporations reporting in a functional currency

The definition of "reporting corporation" is based on whether a corporation has assets that have a total carrying value of $50 million or more at the end of the year. How this rule should be applied for corporations that use a currency other than the Canadian dollar for reporting purposes was not set out in the draft legislation. In particular, it should be clarified how the $50 million threshold is to be calculated when a corporation measures its balance sheet in a functional currency other than the Canadian dollar. This will be especially important for corporations that report in a functional currency for accounting purposes that is not the Canadian dollar and have elected under section 261 of the Act to determine their Canadian tax results in their functional currency rather than the Canadian dollar.

> ***Recommendation –*** For corporations that elect under section 261 of the Act to determine their Canadian tax results in their functional currency rather than the Canadian dollar, we recommend that the proposals include simple mechanics to convert the corporation's assets from their functional currency to Canadian dollars. For example, Finance Canada could consider converting the functional currency assets to Canadian dollars at the spot exchange rate at the end of the taxation year. Since the issue of whether a threshold has been met or not could dictate whether a penalty applies, the mechanics should be part of the legislation and should be clear.

Multiple reporting

An uncertain tax treatment may exist for a specific transaction or event for a specific year. The corporation will presumably continue to track the issue and it will continue to be reflected in the relevant financial statements until the uncertainty no longer exists. If the issue is not a recurring tax treatment, it is not clear whether the issue needs to be reported each year after the year to which the issue relates.

> ***Recommendation*** – Reporting should be required only in the year or years where the computation of the corporation's taxable income (loss) is impacted. Having to continue to report the same issue and information each year creates a duplication of work while providing no new information to the CRA. This should be the case even if the issue in question affects a future return due to an amount carried over from a different taxation year (such as a loss or undepreciated capital cost).

As discussed in the submission made by the Joint Committee on the reportable transaction and notifiable transaction proposals, the mandatory reporting rules do not deal with situations where mandatory reporting is needed under two or even all three of the proposed regimes. It is unreasonable that the same information must be reported in different information returns and potentially be subject to multiple penalties.

> ***Recommendation*** – Amendments should be made to the proposed legislation to clarify the requirements where more than one reporting requirement arises on the same issue, transaction or series of transactions. It should not be necessary to report the same information more than once and multiple penalties should not arise where the information needed by the CRA was provided.

Reporting for events already known to the CRA

Some issues reflected in the financial statements will relate to issues already known to the CRA. This could be an issue already under audit, or an issue where a notice of objection has been filed, or an issue under appeal. In such cases, the reporting of known issues creates additional compliance work without providing additional factual issues to the CRA. The reporting requirements for these tax treatments should be minimized.

> ***Recommendation –*** At a minimum, issues that are already known to CRA through "official" filings such as a notice of objection, or a matter is in the tax court procedures, the disclosure requirements under proposed section 237.5 can be satisfied by describing the issue briefly and referencing the previously filed documents. Consideration should also be given to identifying other processes to reduce the

reporting burden in other circumstances where the CRA has all the relevant facts on a specific uncertain tax treatment.

CRA Powers

Proposed subsection 237.5(8) allows the Minister to use sections 231 to 231.3 to verify or ascertain any information in respect of the reportable uncertain tax treatment including, for greater certainty, any information relating to any transaction, or series of transactions, to which the reportable uncertain tax treatment relates.

The explanatory note for that subsection states that:

> "New subsection 237.5(8) of the Act ensures that the provisions of sections 231 to 231.3 dealing with audits, inspections and powers of enforcement apply to a corporation that is required to file, under new subsection 237.5(2), an information return in respect of a reportable uncertain tax treatment for a taxation year, notwithstanding that, at the time of such audit or inspection, a return of income might not have been filed for the year."

The wording of proposed subsection 237.5(8) appears to be much broader than what is described in the explanatory notes. In particular, the rule as drafted could be employed to gather subjective information beyond the identification of the uncertain tax treatments.

As noted in our introductory comments, taxpayers should not have to disclose subjective information to the CRA provided that it has provided the required factual information. This includes documentation such as tax opinions, the taxpayer's own research and analysis on an uncertain tax treatment, narratives on possible approaches the CRA may take or documentation that relates to likelihood. CRA should be performing its own research and analysis in forming the basis of any reassessment. This is consistent with CRA's policy "Obtaining Information for Audit Purposes (AD-19-02R)" and it should be made clear in the legislation.

> ***Recommendation -*** Proposed subsection 237.5(8) appears to provide powers to the CRA that are broader than what the explanatory notes indicate. As such, this rule should be clarified so that the ability to verify or ascertain should only apply to factual information and not subjective information that was used to determine whether an uncertain tax treatment should be reflected in the financial statements.

***De minimis* reporting threshold needed**

Similar to concerns raised in the submission of the Joint Committee on reportable transactions and notifiable transactions, the UTT proposals should be aimed at providing more information to the CRA on tax issues that are considered material. Gathering information and preparing an information return comes at a cost, and penalties should not be a concern for immaterial issues.

How corporations choose to deal with immaterial tax issues will vary, but where those issues are recorded on the financial statements, that should not trigger a reporting requirement for income tax purposes. The penalty proposed in subsection 237.5(5) can be as high as $100,000 per failure to disclose on a timely basis. Such a penalty would be disproportionate if it is applied to an immaterial uncertain tax treatment that is not reported to the CRA.

Consideration should be given to a *de minimis* reportable amount that then would make the penalty more proportional and would reduce compliance costs. As an example, Australia created a defined "materiality amount"[2] equal to 5% of its Australian current tax expense, except where:

- 5% of its Australian current tax expense exceeds A$30 million – the materiality amount is then A$30 million
- 5% of its Australian current tax expense is less than A$3 million – the materiality amount is then A$3 million
- it has no Australian current tax expense – the materiality amount is then A$3 million.

In the United Kingdom, the *de minimis* amount for reporting uncertain tax treatments is £5M per year (per tax).[3] It is important to note that the original threshold proposed in the United Kingdom's uncertain tax treatment rules was £1m and this was increased to £5m after consultations conducted by the government. We believe this provides strong confirmation that such a rule is needed in the Canadian rules.

> ***Recommendation -*** A de minimis threshold for reporting uncertain tax treatments should be implemented as has been done in the United Kingdom and Australia.

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[2] See definition of materiality amount in the definitions section of the Australian Taxation Office's "Reportable tax position instructions."

[3] See "TT14100 - Threshold test: overview", from the HMRC "Uncertain Tax Treatments by Large Businesses Manual"

Reporting of Uncertain Tax Treatments that offset

Another issue that was addressed in the United Kingdom rules for the reporting of uncertain tax treatments is where the impact of these treatments offset as part of the consolidation process. Under the rule, there is no requirement to report if the net tax effect is less than the £5 million threshold for reporting generally.

> ***Recommendation*** **-** A rule similar to that used in the United Kingdom should be added to the draft legislation and should be based on the de minimis threshold that we also recommend.

Short taxation year concerns

Where a reporting corporation is a member of a consolidated group, and the year end of the reporting corporation does not match the year end used to report results for the consolidated group due to a short taxation year, the reporting corporation's requirement to report within 6 months of year end under proposed 237.5(2) may create concerns.

For example, assume the reporting corporation has a March 31, 2022 year end due to an amalgamation on April 1, 2022, and the year end used for the audited financial statements of the consolidated group is December 31, 2022. During February of 2022, the reporting corporation has a significant transaction. The March 31, 2022 tax return for the reporting corporation is filed before the September 30, 2022 due date. Later in the fall, a decision is released in a court case and based on the decision, the reporting corporation believes that the tax treatment used for the February transaction is defendable but an uncertain tax treatment should be recorded in the consolidated financial statements for the period ending December 31, 2022.

In the definition of "relevant financial statements", reference is made to "audited financial statements that are prepared … for a period of time that ends in, the taxation year." In this example, there is not a relevant period of time that ends during the March 31, 2022 taxation year. In addition, the reporting corporation will not exist at the time of the year end for the consolidated group.

> ***Recommendation –*** The proposals should include a rule to deal with the implications of a short taxation year for a reporting corporation.

Implementation date

The proposals are generally effective for taxation years beginning after 2021.

As discussed in the Joint Committee submission on reportable transactions and notifiable transactions, new reporting requirements should only apply for issues arising after the effective date of the proposals. We believe this is a reasonable approach for the uncertain tax treatment proposals and is also consistent with the approach taken in the U.S. when similar rules were implemented on uncertain tax treatments.

> ***Recommendation -*** At a minimum, all aspects of these rules should apply on Royal Assent generally and on a prospective basis (meaning that the uncertain tax treatments that are reportable on the initial return should be issues became uncertain during that period and not in prior years).