The Joint Committee on Taxation of
The Canadian Bar Association
and
The Canadian Institute of Chartered Accountants

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Madame Monique Jérôme-Forget
Minister of Finance and Minister responsible for Infrastructure
Secteur du droit fiscal et de la fiscalité
Ministère des Finances
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Dear Madame Jérôme-Forget:

We appreciate and welcome this opportunity to submit our comments on and to provide our recommendations regarding the Aggressive Tax Planning Working Paper (the "Paper") recently released by your Ministry. The Actions described in the Paper would represent significant changes to the Québec tax system and affect the environment for businesses in the province. Therefore, we believe this consultation process is a very important one and congratulate your Ministry for providing this opportunity.

The attached submission is made by the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants which is comprised of senior income tax professionals from both organizations. The Committee's primary role is to provide input to tax authorities with respect to income tax matters. That input includes identifying concerns with amendments to the Income Tax Act and other income tax statutes proposed by governments, as well as making proposals for amendments to address issues of a technical nature raised by members of the tax community.

Your introductory comments in the Paper indicate the Aggressive Tax Planning phenomenon was and is a matter of serious concern for Québec's tax authorities. While we would agree that the integrity and fairness of the tax system should and must be protected, any actions taken to curtail perceived Aggressive Tax Planning also need to be fair and respectful of taxpayers' rights to structure and plan their affairs based on the law. We are also concerned that any new measures do not unnecessarily add to uncertainty in understanding and applying tax statutes and that any incremental costs to both taxpayers and the government of administering our tax systems be reasonable and appropriate.

We trust that you will find our comments and recommendations helpful. We would be pleased to meet with you at your convenience to discuss or elaborate on any of the issues discussed in this submission.

Yours truly,

John Van Ogtrop
Chair, Income Tax Committee
Canadian Institute of Chartered Accountants

Paul Tamaki
Chair, Taxation Section
Canadian Bar Association

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CICA-CBA Joint Committee on Taxation

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Québec **Working Paper on Aggressive Tax Planning**

Introduction

The Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants ("Joint Committee") is pleased to provide this written submission to respond to the Working Paper on Aggressive Tax Planning (the "Paper") released by the Québec Minister of Finance and Minister responsible for Infrastructure (the "Minister") in January 2009.

Consultation and Coordination

Appendix 1 of the Paper provides a summary or synthesis of actions under consideration by the Minister (the "Actions"). Any of those Actions will have significant implications to Québec taxpayers and are likely to add to the complexity and uncertainty inherent in the already complex tax systems. Therefore, we believe that it is critical that the effect of any Actions be considered carefully and fully understood before the Minister proceeds with implementation.

Québec taxpayers are also subject to taxation at the federal level and, in many instances, to the taxes of other provinces. In fact, the multijurisdictional nature of the Canadian tax system is one of the factors referred to in the Paper as having facilitated Aggressive Tax Planning in the past. It will be important that any Actions undertaken be coordinated with other jurisdictions to theextent possible. It will be of particular importance that any Actions taken by Québec not result in "double taxation". For example, unilateral extension of the normal reassessment has the potential for such a result if Québec were to assess after the assessing period of another relevant jurisdiction has expired.

We also believe guidelines need to be developed as part of the implementation of any Actions to ensure there is an appropriate balance between the rights of taxpayers and needs of taxing authorities. That is, it will be important that any new powers be exercised with the appropriate level of discretion and caution and not indiscriminately. Penalties should not be imposed in a punitive manner unless it absolutely clear they are warranted.

We understand the government may be looking to act on any or all of the Actions under consideration in an expedited manner. We believe that would be inappropriate in the circumstances. For all the reasons described above, there should be a more extended consultation period during which the government considers and discuss input it receives from all interested parties. In particular, the government should seek further input from interest parties after draft legislation has been developed and released.

Recommendations

We recommend that the Minister and officials of the Ministry of Finance continue to consult with interested parties to ensure all of the consequences of implementation are completely identified and understood and that discussions take place over a period that is sufficient for consideration of alternative views and recommendations. In particular, we recommend that any legislative measures be published in draft form for commentary prior to being tabled in the National Assembly.

We also recommend that any actions taken by the government of Quebec take into account the multijurisdictional character of the Canadian tax system. In particular, any actions should ensure that taxpayers continue to be treated fairly, that any potential for double taxation be identified and avoided and that incremental compliance costs to taxpayers and costs to our governments of administering multiple tax systems are minimized.

Overview of Aggressive Tax Planning

The Paper broadly describes Aggressive Tax Planning ("ATP") as a "tax avoidance transaction that complies with the letter but avoids the spirit of the law". Hence, the apparent connection between the Actions under consideration to a determination that the GAAR (and presumably only the GAAR) can be applied to "defeat" the result of a transaction or series that otherwise complies with the law.

However, we are concerned about some aspects of the way in which ATP is described in the Paper. For example, the Paper indicates ATP refers to a "result obtained in circumstances other than those provided by fiscal policy and not sought by the latter." Furthermore, it is stated that, in the context of income taxes "an ATP is said to be a tax avoidance transaction that consists in reducing the effective tax rate of a particular transaction below the one sought by fiscal policy for such income".

The inference to be drawn is that there is connection between fiscal policy and acceptable tax planning. The Paper suggests taxpayers should have an obligation to assess any tax planning against fiscal policy.

Our tax system continues to based on the principle that a taxpayer is obliged to conform with tax law and that taxpayers are entitled to plan their affairs to minimize their tax burden provided such planning and strategies confirm with the law. The GAAR was added to various tax statutes to apply a standard of conformity with the "object and spirit" of tax laws.

Furthermore, the Paper suggests an aggressive tax plan is usually a "sophisticated transaction" and that "other than the resulting tax benefits, the economic justification of an ATP scheme is generally limited and may even be non-existent." The GAAR looks to the existence of a misuse or abuse of the provisions of the tax statute as a standard for its application. The absence of a non-tax reason for a transaction or arrangement is not necessarily determinative of application of GAAR.

GAAR Penalties

The Paper includes a proposal to introduce an automatic 25% penalty where a transaction is successfully reassessed under GAAR. In particular, the Ministry suggests that imposing a penalty on the taxpayer once the GAAR is brought into play by the tax administration would be a simple process in itself that would generally require no further analysis in addition to that required for the application of the GAAR.

The taxpayer could avoid imposition of this penalty if (i) where applicable, the taxpayer complies with the mandatory early disclosure regime prior to the statutory deadline for filing a tax return for the year in which the transaction occurs, (ii) the taxpayer makes a "preventive disclosure" in respect of the transaction within the same time period, or (iii) the taxpayer establishes its due diligence.

The Ministry's premises for suggesting a penalty include the Ministry's view that the threshold for applying GAAR is very high and that the tax administration will only be successful in upholding a GAAR reassessment where a Court concludes that a transaction is "clearly abusive ("*manifestement abusif*"). However, the determination that there has been an abuse of the Act is made on the balance of probabilities, a threshold which leaves significant room for a legitimate, good faith belief on the part of the taxpayer that the transaction undertaken was not an abuse of the Act.

For this reason, the automatic GAAR penalty being proposed would be fundamentally unfair and inappropriate. The judicial guidance on GAAR is based on the fact that GAAR is neither a penal provision, nor a self-assessment provision. As the Supreme Court of Canada noted in *Lipson*, "GAAR is neither a penal provision nor a hammer to pound taxpayers into submission".

Where the tax administration is of the view that the taxpayer knowingly embarked on a course of action that resulted in a "misuse or abuse" of the Act, existing penal provisions should be relied upon to assess penalties. To the extent that amendments may be required to confirm that such provisions can apply to a GAAR reassessment, these could be brought forward having regard, however, to the established principle that penalties should only attach to conduct amounting to gross negligence. We submit that the judicial guidance on the application of GAAR is not sufficiently developed to support a presumption that the taxpayer knew a transaction was abusive as a basis to impose an automatic penalty in situations where gross negligence is not proven.. The recent decision of the Supreme Court in *Lipson* speaks eloquently to the uncertainty on the scope of application of the GAAR.

We also have concerns as to the ability of a taxpayer to establish a defence of due diligence without compromising the taxpayer's right to solicitor-client privilege. To the extent that the application of GAAR depends on mixed questions of fact and law regarding the technical provisions of the Act and the "object and spirit" of such provisions, a taxpayer's ability to establish due diligence as a defence will often rest on having obtained legal advice. Taxpayers cannot be placed in the position of having to choose between a penalty and waiving a fundamental legal right.

Recommendations

We question whether a new penalty regime is necessary in light of the existing penalty provisions in the Act, which provisions could be adapted to address the Minister's concerns. The GAAR is a tool to be used, ultimately by the Courts, to determine whether or not a taxpayer's position with respect to a transaction results in a "misuse or abuse" of the Act. Given the nature of GAAR and the situations where it is applied (i.e. in cases where technical compliance with the provisions of the Act has occurred), a GAAR penalty will create significant uncertainty for taxpayers who legitimately exercise their right to plan their affairs to minimise their tax consequences. If the Ministry decides to introduce a new penalty, we recommend that any new penalty be based on the need to enforce compliance obligations that are clearly understood and clearly expressed in the legislation.

Therefore, , we recommend that any new penalties that may be introduced be based on failure to comply with reasonable disclosure requirements, as described below.

Disclosure Requirements

In addition to the mandatory early disclosure requirement (discussed below), the Ministry suggests the introduction of a preventive disclosure process, which a taxpayer can initiate with a view to avoiding the proposed automatic GAAR penalty.

Such a disclosure is likened to the advance ruling process, such that it would have to clearly identify the taxpayer, and include a complete and detailed description of the facts (including such a description of the transaction or series of transactions, disclosed, its objects and effects) accompanied by all the relevant documents allowing the tax administration to thoroughly analyse it.

We support the proposal that taxpayers be provided with the opportunity to avoid penalties by complying with a disclosure regime in certain circumstances. Our primary concern in this regard is that any "safe harbour" rule that accompanies a penalty provision must be clear such that the taxpayer can easily determine from the outset the nature and scope of information required to be provided in order to be exonerated from any penalty.

We are also concerned that if the extent of information required under the preventive disclosure process is open-ended, the administrative burden and cost of proceeding with a preventive disclosure will make the process both inefficient for taxpayers and ineffective for the tax administration. In our view, the preventive disclosure should be viewed as complete and should provide exoneration from penalties if all the relevant facts are disclosed to the tax administration.

We believe disclosure consisting of a submission of "all the relevant documents" is inappropriate, imprecise and impractical, and may in certain instances compromise a taxpayer's right to solicitor-client privilege. Any disclosure should be integrated into the taxpayer's annual tax return to the extent possible.

We suggest that the preventive disclosure process be introduced as a mandatory compliance measure in respect of transactions for which there is no reasonable basis for the taxpayer's position that GAAR does not apply. Failure to disclose the transaction where GAAR applies, and where there was no reasonable basis for the taxpayer's position that GAAR does not apply, could be enforced by a penalty. Such a penalty regime would be in lieu of the automatic GAAR penalty suggested in the Paper.

In addition, the taxpayer's decision about whether or not to make preventive disclosure of a transaction could be further informed by the tax administration's publication, from time to time, of a list of transactions, arrangements or positions which, in the tax administration's view, have no reasonable basis. Enhanced communication by the tax administration would assist taxpayers in evaluating whether certain transactions or positions should be disclosed.

In our view, casting the penalty as one related to disclosure of a tax position that has no reasonable basis and to which GAAR applies is less likely to compromise a taxpayer's right to solicitor client privilege than a due diligence defence to a penalty tied to the application of GAAR.   In this regard, we suggest that to avoid imposition of the penalty the taxpayer would have to demonstrate that the taxpayer's position was reasonable. As well, but subject to our comments above relating to the protection of solicitor client privilege, the taxpayer should be entitled to establish a defence of due diligence in evaluating, assessing and reaching its conclusions with respect to any tax position. However, reliance on a "due diligence defence" should in no way compromise a taxpayer's assertion that the taxpayer's position that has a reasonable basis.

<u>Recommendations</u>

We suggest that in lieu of an automatic penalty where GAAR applies, a preventive disclosure process be introduced as a mandatory compliance measure in respect of transactions for which there is no reasonable basis for the position taken by the taxpayer.

Furthermore, we recommend that the tax administration provide greater guidance to assist taxpayers in evaluating their compliance obligations perhaps through publication of a list of transactions, arrangements and positions for which it believes a taxpayer would not a have "reasonable basis". However, any such list should be an administrative aid rather than statutory or regulatory in nature since application of any penalty should ultimately be based on a judicial determination of whether or not a position is reasonable.

We recommend that the disclosure be limited to facts and circumstances.

The fact of disclosure should be "without prejudice" and should not be taken as an admission that the taxpayer lacks a "reasonable basis". The taxpayer should be able to avoid a penalty where it can be demonstrated that the taxpayer's position had a reasonable basis, or where the taxpayer can establish a defence of due diligence.

Promoter Penalties

The Paper indicates one of the Actions under consideration is a penalty on a "promoter" of 12.5% on amounts received by the promoter regarding any avoidance transaction in respect of which a penalty is imposed on a taxpayer. The term "promoter" would be broadly defined as anyone who promotes, markets, or encourages an avoidance transaction, who receives consideration in respect of such promotion, marketing or encouragement, and who has a "substantial role" in such activities. It appears the only basis on which a "promoter" can avoid such penalties is where either taxpayer has made disclosure or the taxpayer has established a due diligence defence.

We believe it is entirely inappropriate that a penalty on a person found to be a promoter be based entirely on the success or failure of the taxpayer in defending against a GAAR reassessment and penalties. In particular, a promoter as defined cannot control or compel a taxpayer to make disclosures as a "safe harbour" against penalties. Furthermore, such a person has no authority or ability to control any defence a taxpayer may pursue.

In order to address the above concerns, we recommend that "promoters" be given their own due diligence defence. We are concerned, however, that this may not be sufficient because some advisers may be precluded from asserting this defence because of professional client confidentiality restrictions.

We also believe the definition of "promoter" as proposed in the Paper is inappropriately broad. In particular, the proposed definition refers to encouragement of the growth of or interest in the transaction at issue. Professional advisors often provide advice to their clients as to potential tax planning techniques and strategies. It seems inappropriate that such activities might expose such advisors to potential penalties if their clients ultimately choose to pursue such strategies possibly without the knowledge let alone concurrence of such an advisor.

Recommendations

We recommend that persons potentially subject to “promoter penalties” be entitled to rely on their own “due diligence” as a defence and therefore that the determination of any penalty not be connected to any taxpayer penalty.

We also recommend that the meaning of “promoter” outline in the Paper be clarified to ensure it does not apply tax advisors who are subject to professional client confidentiality obligations, particularly in the absence of confidentiality agreements and contingent fee arrangements.

Finally, as noted in the Paper, there are already meaningful penalties in both the Québec and federal tax legislation which may already be sufficient to meet the Minister’s objectives in many circumstances. Therefore, any proposed new or extended promoter penalties should take account of these existing provisions.

Mandatory Disclosures

In the Paper, two types of disclosure regimes are discussed. First, a mandatory early disclosure mechanism is suggested, under which taxpayers would have an obligation to report transactions if specific conditions are met. Such a disclosure would be required within 30 days after the transaction begins to be carried out. The consequences of not making the required disclosure on a timely basis are that significant penalties would apply and the limitation period for reassessment of the transactions in question would be suspended as long as the prescribed form is not filed. A preventive “voluntary” disclosure mechanism is also under consideration, which was addressed above. This disclosure, when used, would generally be made with the taxpayer’s tax return for the year in which the transactions arose.

We have a number of concerns about the mandatory disclosure proposal, in terms of the number of transactions that might be caught, the issues and costs related to identifying these transactions in advance and reporting them within the proposed 30-day period, and the fact that the determination of whether or not a transaction is reportable may depend on events that occur after the applicable 30 day filing deadline.

There are many transactions or services provided by professionals that we assume are not considered contentious but may in fact be caught due to the nature of the screening parameters. Any transaction that provides a tax benefit in relation to which a taxpayer retained the services of an advisor, where the “contract between the taxpayer and the advisor includes an undertaking of confidentiality by the taxpayer towards other persons or the tax administration in relation to the transaction” is caught by the proposed disclosure obligation. Most tax planning services will result in a tax benefit of some sort and there are a multitude of reasons why a particular service would be subject to confidentiality (in terms of third parties other than tax authorities in particular) that are not tax-related.

Many tax services are provided by professionals in exchange for a fee that is results based. This is done for business purposes in many situations, and is not at all related to aggressive or risky behaviour. For example, two common services are identifying and preparing documentation for investment tax credit claims on scientific research and experimental development expenditures or identifying errors made by a taxpayer in their indirect taxation filings. Clients often want to pay a contingent fee as they are not sure whether there will be a tax saving until significant work is done (especially where the rules involved are complicated). If the fee is contingent, and the ultimate result of the work is not beneficial, then no professional fees are payable. The cost, however, is that if the client does qualify for a particular benefit, then the professional fees may be higher than what they would have been under a normal fee for service arrangement. Many professionals offer both options to clients. This sort of fee arrangement protects clients against incurring a large professional fee that does not produce a benefit.

It is not clear whether these arrangements would be caught by the mandatory disclosure mechanism even though the contingency is simply whether the client has transactions that qualify for a particular tax treatment, as opposed to whether a tax-motivated plan will work. The mandatory disclosure mechanism appears to be intended to detect situations where the advisor suggests specific tax-motivated transactions that will produce a tax benefit and the fee is contingent on whether the plan works. However, as currently described, the mandatory disclosure mechanism could apply far beyond the intended situations.

Transactions are often implemented for more than one purpose, and in many instances, whether there will be a tax benefit may not actually be known until a tax return is filed if there is more than one option for reporting the transaction(s). There are also a number of instances where events subsequent to the transactions in question may be relevant to a taxpayer's tax reporting where more than one option is available (e.g. discretionary deductions, reserves). For example, there are many non-arm's length transactions where a rollover is available. For many rollovers, there is also the option of not making the election in question and the allowing the transaction to occur at fair market value. In fact, some transactions will occur at fair market value unless a rollover election is made. If the rollover is instrumental in producing a tax benefit in a particular plan, the existence of a tax benefit is not confirmed until the taxpayer files a return or rollover form. In these situations, a transaction or series of transactions could become reportable retroactively based on subsequent events. It would be unduly burdensome to require a taxpayer to make early disclosure of a transaction that ultimately does not provide a tax benefit. It would be equally inappropriate for a taxpayer to be subject to a penalty for late filing in such circumstances. Having to report a transaction early that will ultimately have to be reported in a tax return also represents a duplication of work. Even if a full analysis is done at the time of implementation, it will be revisited when the taxpayer files a tax return.

Given our concerns above, the proposed conditions may capture many non-contentious or relatively insignificant transactions. Therefore, many taxpayers or their advisors may not realize they have a reportable transaction until the final in-depth tax compliance work is done for that particular taxation year.

<u>Recommendations</u>

We believe the Actions under consideration for mandatory disclosure contingent fee arrangements and confidentiality agreements are unnecessarily broad. They would result in unnecessary compliance burdens on taxpayers, additional administrative costs to the government and result in disclosures that represent no risk to the tax base.

We recommend that all mandatory disclosures should be required to be made no later than the statutory filing date for the taxpayer's tax return that covers the particular transaction(s) . This will reduce taxpayer costs, and will also allow taxpayers and their advisors to use all information available to make a final decision on whether a transaction is truly reportable or not.

Where fees are based on the amount of a tax benefit, a specific exception should be made for transactions that are incurred primarily for business purposes. As discussed, contingent fees can be based on simply determining and reporting the tax consequences associated with business transactions and not designing or implementing transactions that are tax motivated. Examples include indirect tax recovery services and preparation of research and development tax credit claims.

We recommend that when reporting details are set, the disclosure requirements should be clear and limited to factual information sufficient to allow tax administration officials to identify and understand the transaction(s) in question only. The disclosure process should not be as involved as complying with a tax audit or the work needed to apply for an advance ruling.

The final proposals must not alter or negatively affect solicitor-client privilege, any rules of professional conduct involving client confidentiality and general advisor business risk limitation practices. Any requirements to disclose arrangements that are subject to confidentially agreements should not apply where the advisor is merely committing to protecting the confidences of its client. In addition, standard language in engagement letters that is intended to protect an advisor from third party claim as a result of reliance on advice given to a client should not be considered to be a confidentiality agreement for this purpose.

Extended Reassessment Periods

The Paper indicates one of the Actions under consideration would be extension of the normal reassessment period by three years where the matter relates to the application of GAAR unless the taxpayer has made either a preventive or mandatory early disclosure. The normal reassessment period is already generally four years from the date of an initial assessment of tax for a period or a determination that no tax is payable. This period is consistent with limitations in other Canadian tax statutes.

We are concerned about extending the normal reassessment period for a number of reasons. Firstly, taxpayers should be entitled to some level of certainty as to when all matters potentially in dispute with respect to a particular period have at least been identified. Four years would seem to be more than enough time for tax authorities to review, audit and identify potential areas where there may be disagreement with a taxpayer's positions including any related to the potential application of the GAAR.

Secondly, extension of the normal reassessment for matters related to GAAR may encourage auditors to raise and pursue the GAAR as a basis for reassessment in order to continue to pursue issues where GAAR is not particularly relevant. Finally, unilateral extension of the normal reassessment period could result in inappropriate double tax if Quebec asserted an incremental tax liability and countervailing relief otherwise available from another tax jurisdiction is not available because of statutory limits on the reassessing period in the other jurisdiction.

Recommendations

We believe existing normal reassessment periods are sufficient and appropriate in the absence of fraud or gross negligence. This time frame should be more than sufficient for the Ministry's auditors to examine any questionable arrangements or transactions

Amendments to GAAR

In view of the highly harmonised nature of the Canadian tax system, we agree that the GAAR provisions in all Canadian jurisdictions should be consistent; accordingly, we agree that the Quebec GAAR should be modified to the extent necessary to meet that objective.

However, the Paper suggests that such an amendment would be a clarifying amendment. We feel compelled to caution your Ministry against recommending retroactive changes to the Québec GAAR. Retroactive tax legislation is repugnant to taxpayers generally, and creates a climate of uncertainty for businesses.

We note that Ontario and Manitoba are referred to in section 2.2.2 of the Paper as jurisdictions that amended their legislation in a similar manner to the amendment proposed to the Québec GAAR. Neither of those jurisdictions gave the measures retroactive effect to a date prior to their announcement date.

Moreover, since the reasons of the Québec Court of Appeal in the *OGT Holdings* case were released on the date the Paper was published, the Ministry did not have the benefit of having read those reasons. The Quebec Court of Appeal dismissed the arguments that the proposed amendments to the Québec GAAR seeks to prevent.

Accordingly, we submit that none of the circumstances outlined in the criteria applied by the Québec government for making retroactive amendments exist in this case and that the concerns raised in the Paper do not warrant that retroactive effect be given to the proposed amendment to the Québec GAAR.

Recommendation

We agree that the Quebec GAAR be modified to the extent necessary to be consistent with and conform to similar provisions in other jurisdictions. However, t none of the proposed changes should be enacted with retroactive effect.