Voluntary tax disclosures: Dispelling the myths

BY STEVEN SITCOFF, SPECIAL TO THE GAZETTE OCTOBER 27, 2011 6:06 PM

Tourists walk on Seven Mile Beach at sunset in George Town, Cayman Islands. Cayman Islands, a tax haven, is the world's fifth-largest financial centre and hosts almost two-thirds of the world's hedge funds

Photograph by: Gary Hershorn, Reuters file photo

On Sept. 30, 2010, Prime Minister Harper made the following pledge in the House of Commons: “If Canadians are using Swiss bank accounts to avoid paying taxes in Canada, those people will face the full force of Canadian law.”

This topic has continued to be politically charged, as an estimated $100 billion is held by Canadians in offshore accounts.

The voluntary disclosure programs of the Canada Revenue Agency (CRA) and l’Agence du Revenu du Québec (ARQ) present an opportunity to access a tremendous new source of tax revenue and bring these individuals back into the tax system.

Generally, these programs permit the disclosure of an offshore account that was previously undisclosed without the threat of civil penalties or criminal prosecution. While initial information may be sent on behalf of a taxpayer on an anonymous basis, the disclosure will not be accepted unless it is regarded as truly voluntary and not made in response to an audit or similar inquiries from the tax authorities.

Rhetoric in the media and political forums have raised certain preconceived notions regarding voluntary disclosures which should be challenged.

The main beneficiaries of the voluntary disclosure program are rich businessmen who own yachts located in tax havens.

This is not necessarily reflective of the actual demographics. Based on an analysis of clients who have engaged our firm to make voluntary disclosures in 2009 and 2010: the average age is 72 and the median age is 75; 41 per cent have inherited accounts that were already held offshore; 43 per cent are female, most of whom are widows; and 51 per cent were immigrants to Canada.

We need to be tough on tax evaders in order to provide an effective deterrent.

Unless a conciliatory approach is taken, these funds are likely to remain hidden offshore. Indeed, the chances of detection are relatively small, especially given the banking secrecy laws in force in many countries where these accounts are held. (A notable exception in this regard is where stolen bank data is obtained by the CRA, as has occurred recently with data from HSBC Switzerland, but affected Canadian clients may, nonetheless, have a limited opportunity to make a voluntary disclosure in these cases.)

Furthermore, a deterrence objective is only relevant to the extent that a tax-avoidance motivation is involved, which may not be true in all circumstances. For example, the account holder may have inherited an account that was already offshore and he or she simply didn't know what to do with it. As well, there are elderly account holders (some of whom opened the accounts before immigrating to Canada decades earlier) who wish to put their affairs in order before they die so as not to burden their children. Clearly, taking a heavy-handed approach would be costly to the Canadian tax system; and taxpayers who wish to come forward voluntarily should not be discouraged from doing so.

Enforcement measures in Canada have proved to have been successful.

The timing of the recent upswing in disclosures is coincidental and largely attributable to pressures created by other factors. First, certain foreign banks in Canada ceased to provide investment services to smaller Canadian clients as a result of regulatory changes in late 2009. Second is the highly publicized pursuit of criminal investigations of UBS and Crédit Suisse bankers and their intermediaries in the United States. Third is the theft of data from certain European banks in recent years.

The programs of the CRA and the ARQ are even-handed and proportionate.

Essentially, the CRA's approach is to tax each of the last 10 years as if the undeclared income or capital gains had been included when the tax return for that year was filed, along with interest thereon. As such, the CRA's program strives to achieve fairness, predictability, and consistency.

The ARQ, on the other hand, takes a vastly different approach. In broad terms, while one component of its program is to tax the last six years of undeclared income and capital gains, it also generally seeks to tax the balance that was in the account at the beginning of the six-year period as if it were earned wholly in that year. Our firm is challenging the legality of Quebec's position before the courts. Although the total tax owing may often be acceptable to the disclosing individual, Quebec residents are, nonetheless, at a disadvantage to other Canadians in this regard. There is little doubt that both the Quebec and federal governments stand to recover far more if Quebec were to harmonize with the federal approach.

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