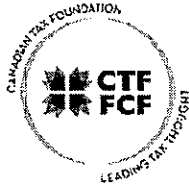




VOLUNTARY DISCLOSURES: NAVIGATING A PROGRAM IN TRANSITION

Michael Friedman
McMillan LLP
Toronto

2016
Ontario Tax Conference
& Live Webcast
Toronto, ON



Voluntary Disclosures: Navigating a Program in Transition

*Michael Friedman,
McMillan LLP, Toronto*

Disclaimer:
This material is for educational purposes only and is not intended to be advice on any particular matter. No one should act on the basis of any matter contained in these materials without considering appropriate professional advice. The presenters expressly disclaim all liability in respect of anything done or omitted to be done wholly or partly in reliance upon the contents of these materials.



Voluntary Disclosures: Navigating a Program in Transition



Voluntary Disclosures: Navigating a Program in Transition

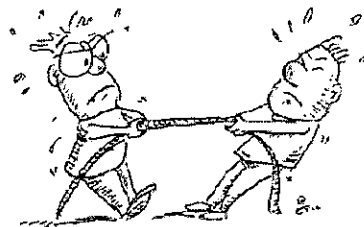
Agenda

1. Background to the Voluntary Disclosures Program (the “VDP”)
2. Recent events and adjustments to the VDP
3. Required elements of a valid voluntary disclosure
4. “No-name” disclosure process
5. Denied voluntary disclosures – Rights of redress
6. Tips and Traps
7. Questions

Voluntary Disclosures: Navigating a Program in Transition

Purpose of the VDP

- Encourage heightened levels of compliance and motivate taxpayers to voluntarily correct past deficiencies
- Competing tension between:
 - Increasing compliance (and tax revenues); and
 - Relieving delinquent taxpayers of penalty (and interest) burdens



Evolution of the VDP

- The federal VDP dates back well over 45 years
 - 1970 – Flexible, relatively unconstrained program (*IC70-9*)
 - 1978 – Available penalty relief narrowed (*IC73-10R2*)
 - 1992 – Scope of penalty relief again expanded (*IC85-1R2*)
 - 2000 – Elements of the modern VDP emerge (*IC00-1*)
 - 2007 – Possibility of partial interest relief recognized (*IC00-1R2*)

Recent Statistics (2014-15)

- 19,134 voluntary disclosures
 - 21% increase in disclosures over the prior year
- More than \$1.3 billion of unreported income voluntarily disclosed under the VDP
 - 65% year-over-year increase
 - \$780 million of such unreported income attributable to offshore holdings (157% increase in such disclosures over the previous year)

Bases for the VDP (*Income Tax*)

1. Subsection 220(3.1) of the *Income Tax Act* (the “**Tax Act**”)
2. IC00-1R4 – “Voluntary Disclosures Program”
3. CRA’s Voluntary Disclosures Program Operations Manual
4. Other CRA/Minister of Finance Releases

Scope of the VDP

- Statutes that fall within the ambit of the VDP
 - *Tax Act*
 - *Excise Tax Act*
 - *Excise Act, 2001*
 - *Air Travellers Security Charge Act*
 - *Softwood Lumber Products Exports Charge Act, 2006*
- Ten year limitation inherent in subsection 220(3.1) of the Tax Act

Relief Offered under the VDP

- **Penalties**
- **Prosecution**
- **Partial interest relief** (in respect of assessments for years preceding the three most recent years of returns required to be filed)

Recent VDP Developments

- Centralization of the administration of the VDP in two Tax Centres – Shawinigan-Sud and Surrey
- Stricter compliance with VDP formalities
- Reduced opportunity for discussion and analysis at the “no-name” disclosure stage
- Heightened focus on offshore compliance

“High-Risk” vs. “Low-Risk” Disclosures

- The CRA applies a “Risk Management” model to distinguish between “High-Risk” and “Low-Risk” voluntary disclosures
- High-Risk disclosures attract greater scrutiny and requests for more extensive documentation
- Applicable Risk Criteria
 - Unreported income > [redacted]
 - Federal tax (Part I, Part XIII, GST/HST) > [redacted]
 - NR4s with gross income (Box 16 and/or 26) > [redacted]

Required Elements of a Voluntary Disclosure

The disclosure must be “voluntary”

- CRA: “A disclosure is considered voluntary if a taxpayer did not initiate the disclosure based on current knowledge of enforcement activities.”



Required Elements of a Voluntary Disclosure

“Enforcement Action”

- Defined expansively by the CRA to include:
 - Requests, demands or requirements issued by the CRA relating to (i) unfiled returns, (ii) unremitted taxes/instalments, (iii) deductions required at source, or (iv) non-registrants
 - Requests, demands or requirements which have been issued with reference to other tax accounts of the taxpayer, partners of the taxpayer, or corporations associated with or related to the taxpayer

Required Elements of a Voluntary Disclosure

“Enforcement Action”

- Direct contact by a CRA employee for any reason relating to non-compliance
- An audit, investigation or other enforcement action by another authority or administration, such as a police force, securities commission or provincial authority

Required Elements of a Voluntary Disclosure

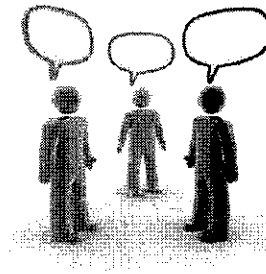
“Enforcement Action”

- Range of authorities that the CRA asserts may conduct “enforcement action” is increasingly broad
- No temporal limit is placed by the CRA on the scope of a particular enforcement action

Required Elements of a Voluntary Disclosure

The disclosure must be “voluntary”

- Three questions are effectively asked by the CRA:
 - 1) Was the taxpayer aware of “enforcement action” set to be conducted by the CRA or another authority?



Required Elements of a Voluntary Disclosure

The disclosure must be “voluntary”

- 2) Has “enforcement action” been initiated by the CRA or another authority on the taxpayer, or on a person associated with, or related to, the taxpayer, or on a third party, where the purpose and impact of such enforcement action is sufficiently related to the present disclosure?
 - Note the absence of a knowledge requirement
 - Captures action in respect of both the taxpayer **and** other persons
 - What is the “purpose and impact” of an enforcement action?
 - What renders an action “sufficiently related” to a disclosure?

Required Elements of a Voluntary Disclosure

The disclosure must be “voluntary”

- 3) Is any of the enforcement action identified in response to the first two questions likely to have uncovered the information being disclosed?
 - The CRA has acknowledged that targeted, unrelated audit activity may not disqualify a disclosure
 - However, the CRA has been aggressive in pursuing tenuous connections between past enforcement action and a disclosure
 - Be mindful of old enforcement action and when it may safely be considered to have been abandoned/resolved

Required Elements of a Voluntary Disclosure

The disclosure must be “complete”

- Taxpayers are not permitted to “pick and choose” which deficiencies to disclose
- The CRA expects the taxpayer to have made all inquiries that a reasonable person would have made to confirm full compliance
- The CRA also expects reasonable inquiries to have been made with respect to the compliance status of all related entities within a corporate group

Required Elements of a Voluntary Disclosure

The disclosure must be “complete”

- Minor omissions or deficiencies in a disclosure will not, in and of themselves, render the disclosure invalid
 - Contrast with “substantial errors or omissions”



Required Elements of a Voluntary Disclosure

The disclosure must be “complete”

- “Low-risk” disclosures generally deemed to be “complete as filed”
- “High-risk” disclosures are subject to greater CRA scrutiny



Required Elements of a Voluntary Disclosure

The disclosure must be “complete”

- Lack of clarity on number of past years that must be included in a disclosure
 - CRA's past practice was to generally only seek to reassess the most recent six taxation years
 - The CRA is increasingly examining years outside of the “normal reassessment period”
 - Availability of records now a relevant practical consideration

Required Elements of a Voluntary Disclosure

The disclosure must involve a “penalty”

- A valid voluntary disclosure must involve the application, or potential application, of a penalty
- Penalties can include discretionary penalties (e.g., gross negligence penalties)
- The CRA does not generally quarrel with the penalties identified by a taxpayer in a disclosure; however, a potential penalty must be disclosed

Required Elements of a Voluntary Disclosure

The disclosed information must be “one year past due”

- The VDP is aimed at providing incentives to rectify enduring non-compliance, and is not intended to solely provide relief from current year errors and omissions
- A disclosure must include information that is at least one year past due, or information that is less than one year past due where the disclosure is to correct a previously filed return or also includes information that is one year past due

“No-Name” Voluntary Disclosures

- Intended to permit a taxpayer’s representative to discuss the validity of a disclosure with the CRA prior to releasing the taxpayer’s identity
- Date of submission of a “no-name” disclosure is the “effective date of the disclosure” (“**EDD**”) for the purpose of assessing whether it has been made voluntarily
- Limited identifying information required to be provided upon the submission of a “no-name” disclosure

“No-Name” Voluntary Disclosures

- Identity of the taxpayer making a “no-name” disclosure must be revealed within 90 days of the EDD
- Historically, the “no-name” process offered an opportunity to have meaningful discussions with the CRA about the potential qualification of a disclosure for acceptance under the VDP
- However, in recent years, limited commitments/insights can be obtained from the CRA at the “no-name” stage
 - Limited CRA resources
 - Concerns over “equitable estoppel”

Denied Voluntary Disclosures – Rights of Redress

Second Level Administrative Review

- May be requested at any time after a decision is rendered by the initial VDP officer
- Second level reviewer directed to consider whether:
 1. all information was considered by the initial VDP officer;
 2. facts or details were misinterpreted, or not considered in their proper context, by the initial VDP officer; and
 3. any new facts or documentation are now being presented that may affect the proper exercise of the CRA's discretion

Denied Voluntary Disclosures – Rights of Redress

Judicial Review

- A request to review the CRA's denial of voluntary disclosure relief must be made to the Federal Court
- Application must be made within 30 days after the date the taxpayer was notified that relief under the VDP has been denied



Denied Voluntary Disclosures – Rights of Redress

Judicial Review

- The focus of a judicial review is on the exercise of the CRA's discretion, not on whether its decision was "correct"
- Applicable standard of review is "reasonableness"
- **Key Question** – Was the CRA's decision one that is supported by reasons "that can stand up to a somewhat probing examination"?

Denied Voluntary Disclosures – Rights of Redress

Judicial Review

- The Court has generally found in favour of the Minister in judicial review cases involving the exercise of discretion under the VDP
- Only five reported cases have been resolved in favour of the taxpayer

Denied Voluntary Disclosures – Rights of Redress

Judicial Review

- Three reported cases involved fact patterns where it was clear on the record that the responsible CRA officer had either failed to consider a critical test set out in the CRA's administrative policies or had reached a factual conclusion without any supporting evidence

Denied Voluntary Disclosures – Rights of Redress

Judicial Review

- Two reported cases involved fact patterns where the CRA rendered a decision that was contrary to (i) its published administrative position in IC00-1, and/or (ii) commitments made to the taxpayer or its representative, giving rise to a finding of equitable estoppel
- CRA policies and administrative practices have been adjusted to address the deficiencies that arose in the foregoing cases

Tips and Traps

1. Condition expectations on the current reality of the “no-name” disclosure process
2. Be mindful of the 10 year limitation on relief available under the VDP
 - Understand the scope of available information at the outset
3. Pay special attention to T1135 filing obligations
4. Consider implications of a voluntary disclosure to current or formerly related persons or associated corporations
 - Advance notification and indemnities

Tips and Traps

5. Try to get commitments in writing from the CRA (or by necessary implication from past correspondence) to support future estoppel positions
6. Consider practical ability to manage payment arrangements
 - Is there a legal basis for what you are proposing?
7. Be mindful of corresponding provincial voluntary disclosure obligations (e.g., Quebec)
8. Second Level and Judicial Reviews – Focus on the facts and the objective basis for the exercise of discretion

Tips and Traps

9. Check Notices of (Re)assessment to confirm voluntary disclosure relief processed as expected
10. Whenever a client is the subject of an audit inquiry, try to ensure that the inquiry is “closed” on the CRA’s system
11. *Tip for Advisors* – Always be clear on when you are going to be able to file a disclosure on behalf of a client

Questions

