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VOLUNTARY DISCLOSURES: NAVIGATING A PROGRAM IN TRANSITION

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Voluntary Disclosures – Navigating a Program in Transition[1]

> When there is an income tax, the just man will pay more
> and the unjust less on the same amount of income.
>
> *Plato* (The Republic)

Few topics engender greater debate than how citizens of a country should be taxed. Central to the Canadian system of income taxation is the concept that taxpayers are required to self report both their income and their tax payable each year. For those taxpayers that fail to meet their tax reporting and payment obligations, Canada's tax laws impose potentially severe sanctions for non-compliance.

Over the past two decades, the federal government has increasingly focused its attention on promoting compliance with Canadian tax legislation by encouraging taxpayers to correct past tax filing and payment deficiencies. The federal Voluntary Disclosures Program (the "**VDP**") marks the government's attempt to simultaneously increase levels of tax compliance, and, correspondingly, government revenues, without disadvantaging those that regularly meet their tax-related obligations.

However, constant debate has encumbered the evolution of the VDP, as the federal government has struggled to balance two competing tensions, which have pulled the administration of the VDP in opposite directions.

On the one hand, the government has pursued the laudable goal of establishing a strong incentive for non-compliant taxpayers to rectify past tax reporting and payment deficiencies and bring their tax affairs into order. To motivate voluntary compliance, the government has offered to waive the imposition of penalties on, and forgo the possibility of criminal prosecution of, taxpayers that make valid voluntary disclosures.

The incentives offered under the VDP have resonated with taxpayers. In 2014-2015, 19,134 disclosures were made to the Canada Revenue Agency (the "**CRA**") under the VDP, resulting in the disclosure of $1.3 billion of previously unreported taxable income.[2] $780 million of such unreported income was attributable to offshore holdings – a 157% increase in such disclosures over the previous year.[3] The number of disclosures made in 2014-15 represented a 26% increase in the number of submissions received by the CRA relative to just three years earlier, and a staggering 50% increase in the amount of previously unreported income.[4]

Yet, on the other hand, the government has struggled with the notion that relieving delinquent taxpayers of the obligation to pay applicable penalties and full interest charges

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[1] The author wishes to gratefully acknowledge the assistance provided by Ehsan Wahidie of McMillan LLP in the preparation of this paper.

[2] CRA, Annual Report to Parliament 2014-2015, (Ottawa: CRA, 2015) at page 59.

[3] *Ibid.*

[4] CRA, Annual Report to Parliament 2011-2012, (Ottawa: CRA, 2012) at page 24.

may be seen as rewarding those that have not diligently met their tax filing and payment obligations and, by corollary, penalizing those that have dutifully complied with their tax obligations.

The intensity of recent media attention on purported tax evasion has further raised the ire of many Canadian taxpayers and increased pressure on the government to ensure that the VDP does not inequitably relieve taxpayers of the consequences of past non-compliance.

The competing pressures faced by the federal government are not unique to Canada. Revenue authorities around the world have struggled with efforts to construct voluntary disclosure programs that encourage the correction of past deficiencies, while simultaneously preserving existing motivations for taxpayers to comply with their tax obligations at first instance.[5]

The VDP has also fallen victim to its own success. Increased participation in the VDP has placed stress on the program, leading to processing delays and the perceived need for stricter standardization protocols. The decentralized operation of the VDP also became the subject of criticism, as calls were made for more consistent administration of the program across the country and greater predictability of outcomes.

The VDP now finds itself in a period of transition. While the merits of maintaining incentives for taxpayers to voluntarily disclose past non-compliance remain clear, the CRA has embraced the need to enhance the efficiency of the VDP in the face of an increasing number of disclosures. The CRA is also grappling with how to balance the degree to which information emanating from foreign authorities under new information sharing arrangements, and from other private sources, should restrict the ability of a taxpayer to make a voluntary disclosure.

This paper provides a summary of the evolution of the VDP with a view to providing insights into where the program may be headed. This paper is also intended to serve as a practical guide to practitioners who represent clients that wish to make a disclosure under the VDP. Attention is focused on the criteria that the CRA applies in exercising its discretion to grant voluntary disclosure relief, the bounds of the relief that may be offered under the VDP, and the rights of redress that a taxpayer may pursue if they are not satisfied with the CRA's response to a particular voluntary disclosure.

It is worthy of note that this paper focuses solely on the federal VDP. Certain provincial and local revenue authorities administer their own voluntary disclosure programs, which, in many respects, are predicated on principles that mirror those that guide the federal VDP. Nevertheless, advisors must remain cognizant of the fact that the tax-related

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[5] See, for example, Elliot H Kajan, "IRS Voluntary Disclosure - To Be or Not,"(2009) 10:6 Journal of Tax Practice and Procedure 39; Larry A Campagna, "Changing Ethics in Light of Recent IRS Voluntary Disclosure Initiatives," 60 Tul. L. Sch. Ann. Inst. on Fed. Tax'n 20-1; Chad Muller and Farley P Katz, "IRS Makes Important Changes to its Voluntary Disclosure Policy," 98 J Tax'n 79; Joanna Mather, "Amnesty for cash economy finds support," 11 Austl Fin Rev 11, March 24, 2015; Joe Stanley-Smith, "Doubts over Italy's €1.5 billion voluntary disclosure target," (2015) 25:9 Intl Tax Rev 5; and HM Revenue & Customs, "Understanding the motivators and incentives for voluntary disclosure," (2015) HM Revenue and Customs Research Report 397.

deficiencies of a particular taxpayer may extend beyond the federal realm to encompass provincial, local or foreign tax exposures that can attract penalties and interest that do not fall within the ambit of the federal VDP.

Evolution of the VDP

The Predecessor to the Modern VDP

Historically, Revenue Canada administered a broad-based voluntary disclosures program, ostensibly authorized under its general authority to administer[6] the *Income Tax Act* (Canada) (the "**Tax Act**").[7] The parameters of Revenue Canada's initial approach to accepting voluntary disclosures was articulated in Information Circulars dating back more than 45 years.[8]

In Information Circular 70-9 – "Tax Evasion and Avoidance", the Department of National Revenue, Taxation described its willingness to grant relief from penalties and prosecution to taxpayers that voluntarily and completely disclosed errors in previously filed "false returns". This statement of policy was subsequently reiterated in updated Information Circulars released over the following four years.[9]

Yet, by 1978, Revenue Canada began to subtly restrict the breadth of its administrative position on voluntary disclosures. In Information Circular 73-10R2 – "Tax Evasion and Avoidance", the Department indicated that the only penalty relief that would be granted in connection with a voluntary disclosure would be relief from penalties levied under section 163 of the Tax Act. The Information Circular expressly indicated that Revenue Canada would "not waive late filing penalties, late remittance penalties, nor interest for late payment".[10]

Revenue Canada's narrow inclination to grant penalty relief was largely affirmed when a new Information Circular relating to voluntary disclosures was next released in 1985 (Information Circular 85-1 – "Voluntary Disclosures").

However, in revised Information Circular 85-1R2, which was released in October of 1992, the Canada Customs and Revenue Agency re-introduced the possibility that the Department might be inclined to grant reporting taxpayers relief from a broader range of penalties. Information Circular 85-1R2 was only three paragraphs in length and stated the Agency's core voluntary disclosure policy in the following terms:

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[6] Jacques Bernier, "Voluntary Disclosures", 2004 Cdn Tax Foundation Conference Report, 34:1-18 at 4.

[7] RSC 1985, c 1 (5th Supp), as amended. Unless otherwise indicated, all statutory references are to the Tax Act.

[8] See, for example, *Information Circular* 70-9, "Tax Evasion and Tax Avoidance," December 11, 1970 at paras 41-43.

[9] See, *Information Circulars* 73-10, "Tax Evasion and Avoidance," May 9, 1973; and 73-10R, "Tax Evasion and Avoidance," November 18, 1974.

[10] *Information Circular* 73-10R2 "Tax Evasion and Avoidance," April 24, 1978.

> If a taxpayer has never filed tax returns, and the returns are then voluntarily filed, the taxpayer will be required to pay only the tax owing on the reported incomes, with interest. If a taxpayer has given incomplete information in a return and subsequently submits the missing information, the taxpayer will be required to pay only the tax owing on the adjusted income, with interest. No prosecution will be undertaken, nor will any civil penalties, including late filing penalties, be imposed, on any amounts included in such voluntary disclosures.[11]

Information Circular 85-1R2 went on to set out the pre-conditions to a valid voluntary disclosure, which bear certain similarities to the modern VDP insofar as (i) disclosures were required to be made voluntarily before the commencement of any audit or enforcement action by the Canada Customs and Revenue Agency, and (ii) payment of the total of any taxes and interest owing was required to be made, or acceptable arrangements for such payment were required to have been concluded with the Agency, as part of the disclosure.[12]

Subsection 220(3.1) of the Tax Act

On May 24, 1991, the federal Minister of National Revenue (the "**Minister**"), Otto Jelinek, announced details of what was dubbed the "Fairness Package" – a set of reforms introduced with a view to improving the fairness of the tax system for all Canadians.[13] In the words of the government, the "Fairness Package" represented an attempt to introduce legislative and administrative measures that would "allow for common sense in dealing with taxpayers who, because of personal misfortune or circumstances beyond their control, are unable to meet our deadlines or comply with our rules".[14]

The legislative centrepiece of the "Fairness Package" was new subsection 220(3.1) of the Tax Act, which read as follows:

> The Minister may at any time waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by a taxpayer or a partnership.

Subsection 220(3.1) empowered the Minister to waive or cancel all or part of any penalty or interest that was payable under the Tax Act in respect of the 1985 and subsequent

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[11] *Information Circular* 85-1R2, "Voluntary Disclosures," October 23, 1992 at para 2.

[12] Interestingly, if a disclosure was found to be incomplete, Information Circular 85-1R2 suggested that the disclosed information would be considered to have been voluntarily disclosed, and that the taxpayer would only be subject to penalties and/or prosecution relating to any "substantial undisclosed amounts". This historical position on the treatment of incomplete disclosures represented a departure from the more restrictive position taken by Revenue Canada in Information Circular 85-1R.

[13] Canada, Minister of National Revenue, "Fairness Package," *News Release*, May 24, 1991.

[14] *Ibid.*

taxation years. The Technical Notes released by the Department of Finance in connection with the enactment of subsection 220(3.1)[15] specified that the discretion granted to the Minister would generally be exercised where taxpayers or partnerships had not complied with a requirement under the Tax Act or a regulation thereunder, or had failed to pay an amount when due, because of extraordinary circumstances beyond their control.

Interestingly, the introduction of the "Fairness Package" and subsection 220(3.1) was premised on the notion that relief should be available in respect of non-compliance stemming from circumstances *beyond a taxpayer's control.* The examples provided in the Technical Notes identified the instances in which the Minister would be inclined to exercise his/her discretion under subsection 220(3.1), including non-compliance attributable to natural or human-made disasters, recent serious illness or accident, or erroneous information provided by Revenue Canada.

The initial commentary offered by the government on the application of subsection 220(3.1) made no mention of the possibility of amnesty from penalties or interest being offered to taxpayers that voluntarily disclosed historical non-compliance. In fact, the Technical Notes to subsection 220(3.1) provided that the Minister would not exercise the discretion granted under subsection 220(3.1) unless the relevant taxpayer or partnership had taken a reasonable amount of care in attempting to comply with the requirements that were the subject of the non-compliance, and the delay in payment or compliance did not arise through neglect or lack of awareness on the part of the taxpayer.[16]

Information Circular 85-1R2 made no mention of the "Fairness Package", despite the fact that subsection 220(3.1) was introduced after the release of the revised Information Circular.

Nevertheless, the CRA subsequently determined that the modern VDP should be grounded in the exercise of the discretionary authority granted to the Minister under subsection 220(3.1). The shift in the CRA's view of the basis for its authority to administer the VDP was likely motivated by careful reflection on the source of the Agency's powers. Absent countervailing legislative provisions, the Minister and its delegates (i.e., principally, the CRA) are obligated to impose all applicable penalties and interest when assessing a taxpayer. While revenue authorities may seek to administer taxation statutes in an equitable manner that may deviate from the strict application of the statute (on the perceived basis of an implied authority to exercise discretion in administering the statute), difficulties may arise, as a matter of administrative law, if the statutory authority and responsibilities bestowed by Parliament on the Minister are not exercised within the confines of a coherent legislative and regulatory framework.

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[15] Explanatory Notes to s. 220(3.1), Bill C-18, SC 1991, c 49, s181(1).

[16] *Ibid.*

The Emergence of the Modern VDP

The CRA announced the parameters of the modern VDP with the cancellation of Information Circular 85-1 and the introduction of Information Circular 00-1 – "Voluntary Disclosures Program" in June of 2000 ("**IC 00-1**"). IC 00-1 has subsequently been revised on four separate occasions, reflecting the evolution of the VDP.

Taxpayers that make a valid voluntary disclosure under the modern VDP will generally be relieved of the obligation to pay any penalties attributable to the reported non-compliance, will not be subject to prosecution, and may be entitled to limited interest relief in respect of certain long-standing tax deficiencies. (The CRA may provide partial interest relief under the VDP in respect of years preceding the latest three years of returns required to be filed by the taxpayer.[17] For such years, the CRA is willing to potentially reduce the applicable rate of interest by 4%.[18] For instance, where the relevant prescribed rate of interest on overdue taxes is 5%, the CRA may reduce the applicable rate of interest to 1%. In the CRA's view, the balance of the interest charged in respect of such outstanding tax amounts (i.e., the 1%) represents the cost of borrowed money to the government.[19])

The modern VDP is intended to serve as a one-time opportunity for a taxpayer to correct tax-related deficiencies and is not intended to permit taxpayers to reduce their level of diligence in attempting to comply with Canada's tax laws, nor to intentionally avoid or delay compliance with their tax-related obligations. Under normal circumstances, a taxpayer may avail itself of the benefits of the VDP only once. However, the CRA may permit a second voluntary disclosure to be made by the same taxpayer "if the circumstances surrounding the subsequent disclosure are *beyond the taxpayer's control*".[20]

The federal VDP offers potential relief from penalties and interest arising under a range of statutes that extend beyond the Tax Act. Relief may also be claimed under the VDP in respect of penalties and interest levied under the *Excise Tax Act,* the *Excise Act, 2001,* the *Air Travellers Security Charge Act,* and the *Softwood Lumber Products Export Charge Act, 2006*.[21]

The VDP was administered by the Investigations Directorate of the Verification, Enforcement and Compliance Research Branch of the CRA until 1999, when it was transferred to the Appeals Division. Following this transfer, the number of VDP requests

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[17] See, *Information Circular* 00-1R4, "Voluntary Disclosures Program," March 21, 2014 at para 12 [IC 00-1R4]

[18] CRA, *Voluntary Disclosures Program (VDP) Operations Manual* (Version 2.0), July 2015, Officer Section at 1.12.2.1 [Operations Manual].

[19] *Ibid.*

[20] IC 00-1R4, *supra* note 17 at para 46.

[21] However, for the purposes of the paper, attention will be focused solely on the administration of the VDP in the context of the Tax Act.

more than doubled from 2,500 in 2000-2001 to 6,100 in 2003-2004.[22] However, in a report by the Auditor General (the "**AG Report**"), the CRA was criticized for its inconsistent administration of the VDP. Following the issuance of the AG Report, administration of the VDP was transferred to the Disclosures and Enforcement Directorate of Compliance Programs of the Audit Branch of the CRA. The VDP has been administered by the Assessment Benefits Services Branch of the CRA since 2013.

Foundations of the Modern VDP

Subsection 220(3.1)

As noted above, subsection 220(3.1) provides the statutory basis for the Minister[23] to grant relief under the VDP in respect of interest and penalties levied under the Tax Act.

In 1992, subsection 220(3.1) was amended to permit assessments resulting from the waiver or cancellation of a penalty or interest in respect of years for which the normal reassessment period has elapsed.

In 2004, subsection 220(3.1) was further amended to provide that the Minister may not waive or cancel a penalty or interest in respect of a taxation year unless the taxpayer[24] has made application for such relief on or before the day that is ten calendar years after the end of the taxation year. According to the government, a ten year limitation period was required because subsection 220(3.1), as introduced in 1991, did not include a mechanism to update the 1985 base year from which the provision began to apply. The government asserted that the amendment was necessary to address the administrative problems that the CRA could otherwise have encountered in verifying claims for taxation years going as far back as 1985.[25]

Subsection 220(3.1) currently reads as follows:

> The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

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[22] *Report of the Auditor General of Canada to the House of Commons,* Chapter 6, "Canada Revenue Agency – Resolving Disputes and Encouraging Voluntary Disclosure," November 2004 at para 6.47.

[23] The Minister has delegated her discretionary authority to the CRA to administer the VDP.

[24] Unless otherwise indicated, reference to a taxpayer includes a partnership in this paper.

[25] Canada, Department of Finance, 2004 Budget, Budget Plan, March 23, 2004, annex 9 at 347.

Historically, the CRA was of the view that subsection 220(3.1) did not vest the Minister with discretion to waive interest in respect of tax deficiencies that had arisen in taxation years that had ended more than 10 years prior to the date upon which discretionary relief had been requested by the taxpayer.

The CRA's interpretive position was successfully challenged in the case of *Bozzer v. The Minister of National Revenue*,[26] wherein the Federal Court of Appeal held that the Minister was permitted to waive or reduce interest payable that had accrued in taxation years that had not ended prior to the last 10 calendar years, notwithstanding the fact that the original tax liability giving rise to such interest had arisen in an earlier taxation year.[27]

The CRA has publicly indicated that it has adjusted its internal assessment policies to accord with the *Bozzer* decision. The CRA's revised interpretive position applies to valid, accepted voluntary disclosure requests made on or after June 2, 2011.[28]

IC 00-1

The CRA has publicly described how it will administer the VDP in IC 00-1. In addition to setting out the criteria that will be applied to guide the exercise of the CRA's discretion in administering the VDP, IC 00-1 also details:

(a) the CRA's expectations regarding the contents of a voluntary disclosure;

(b) the circumstances under which the prospects of granting VDP relief may not be entertained by the CRA;

(c) the manner in which voluntary disclosures may be made to the CRA; and

(d) a taxpayer's rights of redress where the CRA does not exercise its discretion to grant relief in respect of a particular disclosure.

Voluntary Disclosures Program (VDP) Operations Manual

In addition to IC 00-1, the CRA has historically prepared detailed internal operational guidelines to direct the efforts of CRA staff that administer the VDP. While not officially released to the public as a formal external publication, copies of the Operations Manual may be obtained through commercial publication services.[29]

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[26] 2010 FC 139 rev'd 2011 FCA 186 [*Bozzer*].

[27] For example, a valid request for relief under the VDP made prior to the end of 2016, in respect of tax deficiencies that arose in 2004, may rightfully attract a 4% reduction in the applicable interest rate for interest that accrued after the 2005 taxation year and prior to the 2013 taxation year.

[28] A complete description of the changes to the CRA's administrative practices in response to the *Bozzer* decision is contained in Appendix XXI to the Operations Manual, *supra* note 18.

[29] Copies of the Operations Manual have historically been obtained through access to information and other administrative requests.

The Operations Manual describes, in detail, the procedures followed by CRA staff in receiving, reviewing, processing, and responding to voluntary disclosures made by taxpayers. The Operations Manual sets out (i) the criteria to be applied by CRA officials in administering the VDP, (ii) the questions to be posed to taxpayers, and the information to be sought from taxpayers, when reviewing a disclosure, (iii) the documentation requirements and internal protocols that CRA officials are expected to follow in managing the VDP, and (iv) the research and other steps to be taken by CRA staff when assessing whether a taxpayer has met the qualifying criteria for a disclosure to be accepted under the VDP.

The Operations Manual differs substantively, in several key respects, from previous guidelines internally issued by the CRA in respect of the administration of the VDP. In particular, the internal policies and practices of the CRA in respect of the VDP were previously recorded in its "Voluntary Disclosures Program Guidelines", the latest version of which was released in June of 2008 (the "**Historical Guidelines**"). While many of the principles and practices reflected in the Historical Guidelines have been reiterated in the Operations Manual, there are notable differences between the two internal documents. The CRA currently administers the VDP in accordance with the Operations Manual and, as an official matter of practice, does not make reference to the Historical Guidelines.[30]

Other CRA Releases

The Minister and the CRA periodically issue releases, or provide updated information relating to the VDP, on the websites of the CRA and the Department of Finance.[31] Such statements are issued or updated with greater frequency than IC 00-1 or the Operations Manual and represent an important record of current administrative practices in relation to the VDP.

Recent Adjustments to the Administration of the VDP

Since the enactment of subsection 220(3.1), VDP requests were first administered by the local Tax Services Office that had jurisdiction over the area where the taxpayer resided.[32] For businesses, this was based on their operating address. This approach prevented taxpayers and their advisors from shopping for what they perceived to be the most taxpayer-friendly office, or for offices where they had developed working relationships with CRA staff.

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[30] Caution must be exercised when making submissions to the CRA, particularly in the context of requests to review the initial denial of a request for voluntary disclosure relief, to ensure that reliance is not placed on the Historical Guidelines as a statement of current CRA administrative policy. Much of the historical case law that has considered the exercise of the CRA's discretion in refusing to grant voluntary disclosure relief makes reference to the Historical Guidelines. Accordingly, care must be taken when relying on such case law not to place emphasis on outdated or withdrawn CRA internal administrative positions.

[31] For releases by the Minister of National Revenue and the CRA in respect of the VDP, see http://www.cra-arc.gc.ca/nwsrm/rlss/menu-eng.html and http://www.cra-arc.gc.ca/voluntarydisclosures; for Department of Finance releases, see http://www.fin.gc.ca/news-nouvelles/nr-nc-eng.asp.

[32] *Information Circular* 00-1R2, "Voluntary Disclosures Program," October 22, 2007 at para 55 [IC00-1R2]

Over time, certain offices and officers were recognized as having special expertise in dealing with voluntary disclosures. In order to capture efficiencies, and capitalize on the expertise of individuals dealing with such requests, the processing of VDP applications was centralized, and taxpayers were directed to submit disclosures to one of three Tax Centres.[33] In response to additional efficiency and administrative concerns, the CRA has further centralized the administration of the VDP in two Tax Centres.

The Modern VDP – The Fundamentals

The Scope of the VDP

The administration of the modern VDP has been guided by an understanding that the success of the program is predicated on taxpayers being able to obtain fulsome relief from penalties in exchange for voluntarily disclosing past instances of non-compliance. In this regard, the CRA has consistently indicated that relief from penalties or prosecution under the VDP may be granted where a taxpayer has validly disclosed its:

(a) failure to fulfill its obligations under the Tax Act;

(b) failure to report any taxable income they received;

(c) improper claims of ineligible expenses on a tax return;

(d) failure to remit source deductions in respect of employee remuneration or other amounts;

(e) failure to file information returns; or

(f) failure to report foreign source income that is taxable in Canada.[34]

Nevertheless, the CRA has indicated that it will not exercise its delegated discretion to grant relief from penalties or interest under the VDP in respect of:

(a) income tax returns reflecting no taxes owing or an entitlement to a refund;[35]

(b) the submission and processing of elections administered by the CRA that entitle a taxpayer to choose for a specific transaction to be taxed in a particular manner (e.g., the ability to elect to file a "section 216" return under the Tax Act);

(c) the negotiation and administration of "advance pricing arrangements";

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[33] *Information Circular* 00-1R3, "Voluntary Disclosures Program," March 21, 2013 at para 23 [IC00-1R3].

[34] IC 00-1R4, *supra* note 17 at para 18.

[35] The CRA expects such returns to be processed through normal administrative channels.

(d) transactions involving the transfer of property on an elective, tax-deferred basis, including pursuant to section 85 of the Tax Act;

(e) returns required to be filed by a taxpayer in its year of bankruptcy; and

(f) post-assessment requests for penalty and interest relief.[36]

The CRA also periodically issues special announcements that advise on circumstances where voluntary disclosure relief will not be granted. Most recently, the CRA announced that it would not accept voluntary disclosures in respect of specified offshore holdings by taxpayers named in the so-called "Panama Papers".[37]

Required Elements of a Valid Voluntary Disclosure

The CRA has consistently stated that it will only grant relief under the VDP in respect of a disclosure that satisfies each of the following four conditions:

(a) the disclosure must be "voluntary";

(b) the disclosure must be "complete";

(c) the disclosure must involve the application, or the potential application, of a penalty; and

(d) the disclosure must include information that is (i) at least one year past due, or (ii) less than one year past due where the disclosure corrects a previously filed return or also includes information that is at least one year past due.

While seemingly straightforward, each of the conditions to a disclosure being accepted under the VDP is nuanced and warrants careful consideration.

(1) The disclosure must be "voluntary"

No element of the VDP has attracted more attention, or has been the subject of more litigation before the Federal Court, than the CRA's requirement that a disclosure be "voluntary" for it to be accepted under the VDP.

The requirement that a disclosure be voluntary in order to be eligible for penalty and interest relief would, at a high level, appear to be inherently non-controversial. The very purpose of the VDP is to promote voluntary compliance, and to provide an active incentive for taxpayers to correct past instances of non-compliance on their own accord.

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[36] *Ibid* at para 18.

[37] See, statements from Chloé Luciani-Girouard, Press Secretary to Minister of National Revenue in "No Deals for Panama Paper 'Tax Cheats': Canada Revenue Agency", Globe and Mail, September 26, 2016 <Available at: http://www.theglobeandmail.com/news/politics/no-deals-for-panama-papers-tax-cheats-canada-revenue-agency/article32045969/>.

If a taxpayer was permitted to make a valid voluntary disclosure after learning that the CRA or another governmental authority was commencing audit or investigative activity that would uncover past non-compliance, there would be no incentive for taxpayers to correct past deficiencies until it was clear that they were going to be held accountable for such non-compliance by the CRA.

The CRA historically considered a disclosure to have been made voluntarily where the taxpayer "wholly initiated the disclosure in order to ensure his or her tax records are complete before an enforcement action has been initiated that could lead the CRA to the issue being disclosed".[38] More recently, the CRA has internally suggested that "a disclosure is considered voluntary if a taxpayer did not initiate the disclosure based on knowledge of current enforcement activities".[39] It is the CRA's view that a disclosure must meet the foregoing definition of being voluntary in order for it to be considered a valid disclosure.[40]

While the CRA's conception of voluntariness is premised fundamentally on whether the disclosing taxpayer knew of impending audit or enforcement activities by the CRA or another governmental authority that may report to the CRA, the CRA's approach to assessing voluntariness frequently extends beyond a taxpayer's personal knowledge. In particular, the CRA has stated that it will not consider a disclosure to be voluntary if it determines that:

> (a) (i) the taxpayer was aware of, or had knowledge of, an audit, investigation or other enforcement action set to be conducted by the CRA or any other authority or administration with respect to the information being disclosed to the CRA, *or*
>
> (ii) enforcement action relating to the disclosure was initiated by the CRA or any other authority or administration on the taxpayer, or a person associated with, or related to, the taxpayer, or on a third party, where the purpose and impact of the enforcement action against the third party is sufficiently related to the present disclosure, **and**
>
> (e) the enforcement action described above is likely to have uncovered the information being disclosed. [41]

(a) <u>*What Constitutes Enforcement Action?*</u>

The CRA defines "enforcement action" in an expansive fashion as including, but not limited to:

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[38] Historical Guidelines at 3.2.1.

[39] Operations Manual, *supra* note 18 , Officer Section at 1.8.

[40] *Ibid.*

[41] IC 00-1R4, *supra* note 17 at para 32.

(a) requests, demands or requirements issued by the CRA relating to (i) unfiled returns, (ii) unremitted taxes/installments, (iii) deductions required at source, or (iv) non-registrants;

(b) requests, demands or requirements which have been issued with reference to other tax accounts of the taxpayer, partners of a taxpayer, or corporations associated with or related to the taxpayer;

(c) direct contact by a CRA employee *for any reason* relating to non-compliance (e.g., unfiled returns, audit, inquiries, collection activities); and

(d) an audit, investigation or other enforcement action by another authority or administration, such as a police force, securities commission or provincial authority.[42]

The CRA has suggested that the temporal scope of a particular enforcement action will not be limited by the years for which a particular inquiry has been made by the CRA or another government authority. In IC 00-1, the CRA expressly states that enforcement action in respect of a particular matter that focuses on a single taxation year will nevertheless preclude the taxpayer from making a valid voluntary disclosure in respect of such a matter for any taxation year.[43] As a consequence, if the CRA makes an inquiry relating to the source withholdings made by a taxpayer in respect of a single taxation year, the CRA is of the view that the taxpayer will be precluded from disclosing withholding tax deficiencies in respect of any of its taxation years unless the inquiry is validly concluded without uncovering the information at issue.

The CRA has consistently expanded the range of authorities and administrative bodies that may conduct enforcement action that could preclude a disclosure from being considered to be voluntary under the VDP. In previous public statements, the CRA had restricted the range of authorities that could be said to be conducting such enforcement action to those authorities that had some form of information exchange agreement with the CRA. However, the CRA's ability to deny a voluntary disclosure on the basis that it had received information from another governmental agency was successfully challenged before the Federal Court where the taxpayer demonstrated that he was not aware that the agency in question had an information exchange agreement with the CRA.[44] As a consequence, the range of agencies that may conduct enforcement action for the purposes of the VDP is now defined expansively by the CRA.

Much attention has also been devoted to analyzing whether computer-generated notices issued by the CRA requesting that a taxpayer (i) file outstanding tax or other information returns, (ii) remit outstanding income tax, GST/HST, or withholdings, or (iii) register for

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[42] *Ibid* at para 33.

[43] *Ibid.*

[44] See, *Karia v Minister of National Revenue,* 2005 FC 639 [*Karia*].

tax purposes, should be considered to be enforcement action for the purposes of the VDP. While the CRA has indicated that such correspondence is *prima facie* an enforcement action, it has acknowledged that a voluntary disclosure should not be precluded on the basis that it is not voluntary if the CRA has not followed-up on a computer-generated notice that was issued far in the past (e.g., the request could validly be considered to have been abandoned by the CRA).[45] The CRA has also acknowledged that it is possible that computer-generated correspondence may not be received by a taxpayer.[46] Accordingly, a disclosure may be considered to be voluntary where a taxpayer can satisfy the CRA that a computer-generated notice was not received by the taxpayer (however, see further commentary below).

In recent years, the CRA has undertaken specialized letter writing and other campaigns to alert taxpayers to potential non-compliance.[47] The CRA has stated that such actions are not intended to constitute "enforcement action" for the purposes of the VDP. In fact, such letters frequently reference the ability of a taxpayer to potentially make a voluntary disclosure in respect of non-compliance referenced in the correspondence. When assessing whether "enforcement action" has commenced for the purposes of the VDP, it is important for taxpayers to carefully document any bases to distinguish CRA contact relating to specific non-compliance with more generic contact.

Finally, the CRA has confirmed that enforcement action that is at an embryonic stage should not, in certain circumstances, be considered to have invalidated a disclosure. In this regard, the CRA has directed its voluntary disclosure officers to make inquiries as to the advancement of an early stage enforcement action when assessing the application of the voluntariness criterion, particularly where there is an indication that the taxpayer may not yet have become aware of such enforcement action.[48]

(b) *Tests to Assess Voluntariness*

An assessment of whether a disclosure will be considered by the CRA to be voluntary requires three distinct questions to be answered:

(a) Was the taxpayer aware of enforcement action set to be conducted by the CRA or another governmental authority in respect of the information to be disclosed?

(b) Has enforcement action relating to the disclosure been initiated by the CRA or another governmental authority on the taxpayer, or on a person associated with, or related to, the taxpayer where the purpose and impact of such enforcement action is "sufficiently related" to the present disclosure?

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[45] Operations Manual, *supra* note 18, Officer Section at 1.8.1.2.

[46] *Ibid.*

[47] CRA, "The CRA letters about your rental, business professional or employment activities," (January 20, 2016) online: CRA < http://www.cra-arc.gc.ca/lettercampaign/>.

[48] Operations Manual, *supra* note 18, Officer Section at 1.8.1.3.

(c) Is any enforcement action described above likely to have uncovered the information being disclosed?

(i) Awareness/Knowledge of Impending Enforcement Action

The CRA has stated that if a taxpayer is aware that any form of enforcement action is set to be conducted by the CRA or any other authority or administration with respect to information that is to be disclosed, the disclosure will not be considered to be voluntary. Central to any such determination is what constitutes awareness or knowledge of impending enforcement action.

If a taxpayer receives a telephone call or written correspondence from the CRA alerting him/her of an impending general audit, it will not be difficult to impute awareness or knowledge to the taxpayer that the subject matter that they are intending to disclose will potentially be discovered by the CRA. However, other circumstances can raise greater interpretive ambiguity. For instance, is a taxpayer to be said to have knowledge of an impending audit if a former advisor or accountant is contacted by the CRA with respect to a past tax filing? If a provincial licensing body poses compliance question to a taxpayer relating to its commercial operations, could such inquiries be considered to be enforcement action in respect of the tax position of the taxpayer for the years under consideration? Is the taxpayer deemed to have knowledge of an impending enforcement action if they never received notification alerting them to the commencement of such action (e.g., a letter that is never received or a voicemail message that is not transmitted)?

The CRA has historically taken an aggressive stance on attributing awareness or knowledge of pending enforcement action to a taxpayer where persons controlled by, or in partnership with, the disclosing taxpayer have been alerted to an impending audit of common or linked business activities.[49]

The potential for the CRA to adopt an aggressive posture in assessing whether a taxpayer may have knowledge of an impending audit places the taxpayer in a possible "catch 22". If the disclosing taxpayer searches out, and becomes aware of, knowledge of audit activity in respect of a common or linked activity being undertaken by a controlled entity or business partner, the taxpayer's ability to make a disclosure will likely be foreclosed. Conversely, if a disclosure is made by the taxpayer, and it is subsequently determined that a related party or business partner was the subject of audit activity, a practical onus may be placed on the taxpayer to demonstrate that they had no awareness of such audit activity.

(ii) Enforcement Action Initiated Against the Taxpayer, Related Persons, Associated Corporations or Third Parties

IC 00-1 indicates that the CRA may declare a disclosure to be involuntary where enforcement action has been commenced against the taxpayer, persons related to, or

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[49] See, for example, *Livaditis v Canada Revenue Agency (CRA)*, 2010 FC 950 aff'd on other grounds 2012 FCA 55 [*Livaditis*]; *Poon v R,* 2009 FC 432 [*Poon*].

associated with, the taxpayer, or third parties where the "purpose and impact" of the enforcement action is "sufficiently related" to the disclosure being made by the taxpayer. While it stands to reason that a taxpayer should be aware of audit activity that has been initiated against itself, such awareness is not necessarily present in respect of enforcement action undertaken against other parties.

The definitions of "related persons" and "associated corporations" are contained in sections 251 and 256 of the Tax Act, respectively. Related persons can include siblings or other blood relatives with which a taxpayer may have limited or no contact. Similarly, where the disclosing taxpayer is a corporation that is part of a large or extended corporate conglomerate, it is possible that management of the taxpayer may not have knowledge or regular interaction with other associated corporations within the group. Problems with imputed awareness may be even more acute with respect to the affairs of other third parties. The CRA has previously stated that awareness of enforcement action in respect of a related person or an associated corporation is not required for a voluntary disclosure to be invalidated on the basis that it is not voluntary.[50]

The CRA has not provided guidance on how one determines the "purpose and impact" of a particular enforcement action. However, one might logically reason that for the "purpose and impact" of an enforcement action to be sufficiently related to a particular disclosure, its objective must be to collect information in respect of activities that are linked or rationally connected to the affairs of the taxpayer, and the consequences of the enforcement action must reasonably be expected to generate information that will likely direct the attention of the CRA to the tax affairs of the disclosing taxpayer that are the subject of the contemplated disclosure.

Prior to making a voluntary disclosure, taxpayers should consider the prudence of making reasonable inquiries to determine whether related persons, associated corporations or other third parties with which they have common business dealings may have received notification of the commencement of an enforcement action that could reasonably direct the attention of the CRA to the information being disclosed by the taxpayer.

(iii) Causation/Attribution

For a voluntary disclosure to not be considered to be voluntary, an enforcement action identified by the CRA must have been likely to have uncovered the information being disclosed.[51]

The CRA has acknowledged that targeted forms of audit activity may not disqualify a disclosure from being considered voluntary when such activity focused on an entirely unrelated manner.[52]

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[50] *Livaditis*, *supra* note 49.

[51] IC00-1R4, *supra* note 17 at para 32.

[52] *Ibid* at para 34.

The Operations Manual provides several sample scenarios involving enforcement actions directed toward a particular topic that may not preclude a taxpayer from making a valid voluntary disclosure in respect of a separate matter. The scenarios presented in the Operations Manual include the following:

- The CRA recently conducted an audit of a taxpayer relating to employee source deductions. The same taxpayer may potentially submit a voluntary disclosure in respect of Goods and Services Tax that was collected, but not remitted, to the CRA.

- A "large corporation" is continually under audit by the CRA and the applicable audit protocol calls for the review of specified tax matters. The corporation may potentially submit a voluntary disclosure with respect to non-compliance with a statutory requirement that was not set to be reviewed under the applicable audit protocol.

- A computer-generated request for a return is sent by the CRA to a taxpayer. The taxpayer may voluntarily disclose the failure to file the return originally referenced in the computer-generated notification if a "significant amount of time"[53] has elapsed between the date of the computer-generated notice and the date that the taxpayer subsequently made its disclosure, such that it is reasonable to conclude that the enforcement action has been abandoned by the CRA.[54]

Notwithstanding the foregoing, the CRA has been aggressive in taking the position that enforcement action that might otherwise be considered to only be tenuously connected to a matter being disclosed would have ultimately uncovered that matter.[55]

Moreover, the CRA has not provided any guidance on how much time it considers necessary to have elapsed before a previous enforcement action will no longer preclude a voluntary disclosure from being made. The CRA's standing position is that such an assessment must be conducted on a case-by-case basis. However, past case law suggests that the CRA takes the position that the mere passing of a few months from the receipt of an audit inquiry is not sufficient to consider the inquiry to have been abandoned.[56]

(c) *Internal CRA Review*

The Operations Manual provides VDP officers with a checklist of the internal computer databases that must be reviewed to determine whether enforcement action has been

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[53] The Operations Manual expressly provides that what constitutes a "significant amount of time" for this purpose is entirely within the discretionary judgment of the relevant CRA officer.

[54] Operations Manual, *supra* note 18, Officer Section at 1.8.1.2.

[55] See, for example, *Amour International Mines d'Or Ltee v Canada (AG)*, 2010 FC 1070 [*Amour*], where the Minister took the position that a letter requesting certificates of compliance in respect of a disposition would have uncovered that a subsidiary entity had failed to remit Part XIII amounts withheld.

[56] *Robinson v Canada,* 2010 FC 795.

undertaken in respect of a particular taxpayer.[57] VDP officers are also expressly directed to ask several questions when assessing whether a disclosure may be considered to be voluntary, including the following:

- Have returns or permanent documents in respect of the taxpayer been charged out internally by other CRA staff?
- Have recent assessments or reassessments been issued in respect of the taxpayer?
- Have computer-generated requests to file returns been issued to the taxpayer?
- Is there any audit or other investigation activity in progress within the CRA in respect of the taxpayer?
- Where relevant, has there been any audit or investigation activity in related provincial tax administrations such as Revenu Quebec?
- Is there any record of any direct contact with the taxpayer by CRA employees for any reason relating to non-compliance?[58]

(2) The disclosure must be "complete"

The operational premise of the VDP is that a taxpayer is being given an opportunity to rectify all past non-compliance and make a "fresh start" with a view to adhering to its tax reporting and payment obligations in the future. The VDP is not intended to be a selective mechanism whereunder a taxpayer can pick and choose which instances of non-compliance it wishes to disclose (presumably out of fear that they may eventually be detected) and omit disclosure of other past non-compliance that it may believe is less likely to be uncovered.

As a *quid pro quo* for obtaining penalty and potential interest relief, the CRA expects a taxpayer to make a *bona fide* effort to analyze its historical tax affairs, identify all deficiencies, and report and rectify such deficiencies as part of its disclosure.

To be considered a "complete" disclosure, the CRA has indicated that a disclosing taxpayer "must provide full and accurate facts and documentation for all taxation years or reporting periods where there was previously inaccurate, incomplete or unreported information relating to any and all tax accounts with which the taxpayer is associated".[59] In this regard, the Operations Manual indicates that "a disclosure is considered complete if the taxpayer has brought forward for discussion with the VDP officer all material omissions, concerning information that was previously inaccurate, incomplete, or unreported, and, *for High Risk files,* a review of the file shows no substantial omissions in

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[57] Operations Manual, *supra* note 18, Officer Section at 1.8.1.

[58] *Ibid.*

[59] IC00-1R4, *supra* note 17 at para 35.

any program line (for example, income tax, GST/HST, payroll), or within *legal entities* in a corporate group".[60]

The CRA expects that a disclosing taxpayer will have made all inquiries that a reasonable person would make to determine whether it is in full compliance with its tax reporting and payment obligations in all program lines.[61] Moreover, the CRA expects the taxpayer to make reasonable inquiries with respect to the compliance status of all related entities within its corporate group.[62]

In the CRA's view, the extent to which inquiries will be expected to have been made will be influenced by (i) the "risk level" of the disclosure assigned by the CRA, (ii) the nature of the disclosure, (iii) the resources or size of the taxpayer, and (iv) the internal relationships of the taxpayer's business lines. Nevertheless, the CRA cautions that the mere fact that a taxpayer is large will not absolve the taxpayer's management of its responsibility to ensure that a disclosure is complete. The CRA has also expressly stated that "where an individual controls a group of entities, it would generally be expected that a disclosure would involve any omissions within the group".[63]

It has been the CRA's long standing policy that minor omissions or deficiencies in the completeness of a disclosure will not, in and of themselves, render the disclosure invalid. By contrast, if the disclosure is found to contain "substantial errors or omissions", the disclosure may not qualify as a valid disclosure. [64] The CRA has suggested that what constitutes a "substantial error" is to be determined on a case-by-case basis. By way of example, the CRA has suggested that if a taxpayer discloses unreported income of $100,000, and the CRA subsequently determines that the taxpayer's income was, in fact, $108,000, the disclosure would still be considered to have been complete.[65]

Unfortunately, the bounds of what constitutes a minor omission or error are not clear. Does the CRA's internal example suggest that any variance under 8% in the accuracy of a reported deficiency would not be considered to be substantial? Do the applicable variance percentages change depending upon the absolute size of a deficiency (i.e., is an 8% variance in a reported figure of $100,000 acceptable, but not if the reported figure is $1,000,000)?

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[60] Operations Manual, *supra* note 18, Officer Section at 1.9.

[61] Prior to 2007, the CRA permitted employers to disclose and remit to the CRA income taxes and interest charges in respect of income from offices or employment, including the value of taxable benefits, that had not been included on their employees' T4 slips. Such arrangements were known as "employer requested resolutions" ("**ERRs**"). The intent of the policy underlying ERRs was to ease the administrative burden that would be borne by both large employers and the CRA if adjustments were required to be made in respect of taxable benefits paid to hundreds or even thousands of employees of a particular taxpayer.

The CRA no longer entertains ERRs, and its policy in respect of ERRs has been withdrawn. As a consequence, deficiencies with respect to the reporting and taxation of employment benefits may now only be rectified by voluntary disclosures made by both an employer and each of the affected employees.

[62] Operations Manual, *supra* note 18, Officer Section at 1.9.

[63] *Ibid.*

[64] *Ibid* at 1.9.1.

[65] *Ibid.*

While the CRA has not provided concrete guidance on the acceptable levels of variance between reported and actual figures in a disclosure, the CRA expressly treats "low risk" and "high risk" disclosures differently.

The VDP is governed internally at the CRA by a Risk Management model.[66] The Risk Management model designates whether a disclosure will be considered to be a "low-risk" disclosure or a "high-risk" disclosure. A disclosure will be considered to be a "high-risk" disclosure where (i) the unreported income disclosed exceeds a specified threshold, (ii) the federal tax disclosed as being payable exceeds a specified amount, or (iii) NR4s disclosed as not having been filed reflect cumulative gross income amounts (in Boxes 16 and/or 26) that exceed a specified amount.[67] The actual thresholds that the CRA's Risk Management model employs to demark a disclosure as a "high-risk" disclosure have been redacted from the publicly released version of the Operations Manual; however, it remains useful to understand that the preceding criteria determine whether a disclosure will be considered to be "low-risk" or "high-risk".

For internal administrative purposes, the CRA has indicated that if a disclosure covers multiple years, and one of the disclosed years relates to information that exceeds one of the applicable "high-risk" category thresholds, the entire disclosure for all disclosed years will be considered to be "high-risk", irrespective of the balances that are being disclosed for the other years. [68]

For "high-risk" disclosures, the VDP officer is expected to (i) review the file for possible additional business lines or partners, (ii) review the disclosure to ensure that reasonable explanations have been offered to support particular technical positions documented in the file and that such positions appear to be reasonable, (iii) review the file to ensure that the amounts reported are supported by appropriate documentation and ensure that sufficient questions have been posed to the taxpayer to confirm that the disclosure contains complete information, and (iv) ensure that sufficient details have been provided to explain what years are the subject of the disclosure and to ensure that criteria for reassessing statute-barred years have been considered.[69]

By contrast, for "low-risk" disclosures, the CRA deems the disclosure to be complete as filed. The applicable VDP officer is directed to undertake only a "cursory review of the file… in order to review that amounts disclosed, calculations, [and] supporting documents, appear to be acceptable and reasonable as filed".[70]

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[66] *Ibid*, Intake Section at 3.

[67] *Ibid.*

[68] *Ibid.*

[69] *Ibid*, Officer Section at 1.9.4.

[70] *Ibid.*

The Operations Manual expressly directs that for both "low" and "high risk" files disclosures involving "foreign banks of interest" and "countries of interest" are subject to special review and assessment procedures.[71]

(a) *Years within scope of disclosure*

It is open to the CRA to request information from past taxation years to assess whether a taxpayer's disclosure completely describes all past acts of non-compliance. In this regard, much debate has focused on the number of years that should be required to be included in a voluntary disclosure. In many instances, a taxpayer's records dating back to prior taxation years may be increasingly sparse. The requirements to produce records from many years in the past may discourage taxpayers from making disclosures where there is a lack of information to justify past filing positions.

Historically, it was the CRA's general practice to only seek to reassess the most recent six taxation years of a taxpayer.[72] However, such limitation was not reiterated in the Operations Manual.

For an error or omission that extends across multiple taxation years, the CRA has not provided clear guidance with respect to how many past taxation years it may seek to review. Generally, the CRA may reassess all years in respect of which (i) the "normal reassessment period" has not expired, and (ii) years falling outside of the "normal reassessment period" for which the CRA is entitled to reassess under the exceptions to the general reassessment limitation in subsection 152(4) of the Tax Act.

In determining whether information should be requested in respect of years for which the normal reassessment period has otherwise expired, the CRA has advised its VDP officers to consider the following factors:

- Whether a significant portion of the disclosed omission relates to years prior to those contained in the normal reassessment period.
- The taxpayer's compliance history.
- The duration of the non-compliance period.
- The complexity of the non-compliance.
- The taxpayer's knowledge and expertise.
- Whether trust funds, such as source deductions, have been collected or withheld and not remitted.
- Whether source deductions have not been collected or withheld.[73]

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[71] *Ibid*, Officer Section at 1.9.7.4.

[72] CRA, Appeals Branch, "Voluntary Disclosures Guidelines," September 30, 2002 at para 8.2.10.

In order to reassess a taxpayer outside of the "normal reassessment period", the statutory exceptions to the general limitation in subsection 152(4) of the Tax Act must generally apply. The CRA has been aggressive in seeking to assess taxpayers outside of the applicable normal reassessment period by asserting that the exception in subparagraph 152(4)(a)(i) applies because the taxpayer made a "misrepresentation that is attributable to neglect, carelessness or wilful default... in filing the return or in supplying any information under [the Tax] Act".

For instance, in *College Park Motors v The Queen*,[74] the corporate taxpayers applied for relief under the VDP in respect of their failure to disclose liability for Part I.3 tax under the Tax Act. While the corporate taxpayers were not individually large corporations, they were members of a single group of associated corporations, which resulted in the taxpayers being subject to Part I.3 tax. The income tax returns and financial statements of the associated corporations were prepared by the same accountant, and a director of the taxpayers met with the accountant annually to review such documentation. Despite the fact that the Court had "no doubt that [the director and the accountant] are both careful and conscientious people", the Court nonetheless upheld the CRA's right to reassess the taxpayers' statute-barred taxation years on the basis of subparagraph 152(4)(a)(i). In reaching its conclusion, the Court held that the taxpayers were careless because, on the second page of their respective corporate income tax returns, there were questions relating to Part I.3 tax. In the Court's view, had a director reviewed the returns "as carefully as a wise and prudent taxpayer would", he would have asked for an explanation of the Part I.3 tax and would have learnt that the taxpayers were, in fact, liable for the tax.[75]

In light of the low threshold set by the Court in *College Park Motors* for determining when a taxpayer has made a misrepresentation attributable to carelessness, taxpayers should consider the possibility that the CRA may seek to reassess taxable years outside the "normal reassessment period" prior to making a voluntary disclosure.

(3) The disclosure must involve the application, or potential application, of a penalty

The primary incentive offered under the VDP to encourage taxpayers to voluntarily disclose past acts of non-compliance is the potential relief from penalties. In the absence of an applicable penalty, the CRA has reasoned that there is no need for a taxpayer to make a voluntary disclosure to address a historical deficiency, and that the subject non-compliance can be addressed through normal assessment channels. Nevertheless, many taxpayers seek to make voluntary disclosures with a view to avoiding potential prosecution, or to secure partial interest relief in respect of taxation years in the more distant past.

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[73] Operations Manual, *supra* note 18, Officer Section at 1.9.12.

[74] 2009 TCC 409 [*College Park Motors*].

[75] *Ibid* at para 19.

In the context of assessing whether a penalty may be applicable in respect of a particular act of non-compliance, the CRA has acknowledged that relief from discretionary penalties may be sufficient to permit a disclosure to be made under the VDP. Appendix XV to the Operations Manual identifies the particular penalties under the Tax Act that the CRA may consider as the basis for voluntary disclosure relief, which includes a number of discretionary penalties. In fact, when assessing whether a penalty is applicable in the course of judging whether a disclosure may be made under the VDP, the CRA has acknowledged that "discretionary gross negligence penalties are generally applicable when no other penalties apply".[76]

Ultimately, care must be taken to clearly identify the penalty from which relief is being sought in the body of any written request for relief under the VDP.

(4) Disclosed information must be "one year past due"

The VDP is aimed at encouraging taxpayers with enduring non-compliance to come forward and correct past deficiencies. The CRA has long been concerned with guarding against the possibility that taxpayers may seek to use the VDP as a means of simply extending deadlines on a short term basis, or providing a "safety valve" that will permit taxpayers to ascribe less urgency to periodic compliance requirements under the Tax Act. As a consequence, the CRA provides that a disclosure will only be considered to be valid if the information disclosed includes 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 the disclosure contains information that is also one year past due.[77]

The CRA recognizes that certain disclosures may cover non-compliance that extends back several years, but which also includes deficiencies in the current taxation year. While the disclosure of current year deficiencies alone might not satisfy the overall purpose of the VDP, it would be inequitable and unpragmatic to preclude a taxpayer from making a disclosure because a portion of the disclosure relates to current year deficiencies. In fact, where an act of non-compliance (e.g., the failure to file certain information returns) extends across several years, if a taxpayer were not permitted to disclose a current year deficiency, one might question whether the disclosure would otherwise be invalidated by virtue of not being complete.

Fortunately, the CRA has historically not been dogmatic in enforcing the one-year past due requirement, and has instead adopted a principled approach to its application where it is clear that a *bona fide* attempt is being made to rectify past acts of non-compliance and is not simply an attempt to extend a current year submission deadline. In addition, in assessing the one-year past due condition, as an administrative matter, the CRA offers a five-day grace period when determining whether a one-year period has elapsed.[78]

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[76] Operations Manual, *supra* note 18, Officer Section at 3.3.

[77] IC 00-1R4, *supra* note 17 at para 39.

[78] Operations Manual, *supra* note 18, Officer Section at 1.6.

Making a voluntary disclosure

Prior to the issuance of IC 00-1, most voluntary disclosures were required to be made on a named basis (i.e., taxpayers were required to reveal their identity in order to secure a commitment that voluntary disclosure relief would be granted).

In 2007, the CRA introduced the concept of a "no-names" voluntary disclosure. The "no-names" voluntary disclosure process would permit a taxpayer's advisor and the CRA to have discussions about whether a valid voluntary disclosure was possible prior to the identity of the disclosing taxpayer being revealed. Under the terms of the "no-names" program, if the taxpayer were to be audited in the intervening period before its identity was disclosed to the CRA, the CRA would treat the disclosure as having been made at the commencement of the "no-names" disclosure process such that the intervening audit activity would not preclude the disclosure from being accepted under the VDP.

In the case of both "named" and "no-names" disclosures, the disclosure is required to be initiated in writing by a submission to a designated Taxation Centre. (The Taxation Centre to which a voluntary disclosure must be submitted is based upon the residence or principal place of business of the disclosing taxpayer.) Disclosures must be mailed or faxed to the designated Taxation Centre.[79]

Most voluntary disclosures must now be submitted to the CRA's Shawinigan-Sud Taxation Centre. The only exception to this general rule relates to taxpayers that are residents of, or whose principal place of business (for corporations) is in, British Columbia or the Yukon Territory. Taxpayers that fall in the latter geographical regions are required to file their voluntary disclosures with the Surrey Taxation Centre.[80]

The CRA requires that any voluntary disclosure submission contain the following information:[81]

- The name, address, telephone number, social insurance number, partnership number, trust account number, business number, licence number, GST/HST registration number or any other identification tax number assigned by the CRA to the taxpayer (such information is not required in the context of a no-names disclosure).

- The taxpayer's postal code (if the disclosure is a no-names disclosure, only the first three characters of the taxpayer's postal code are required, ostensibly to confirm the Taxation Centre with which the disclosure should be filed).

- The address of the taxpayer's authorized representative, including the telephone and fax numbers, where applicable.

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[79] IC 00-1R4, *supra* note 17 at para 23.

[80] *Ibid* at para 23.

[81] *Ibid* at para 44.

- Gender and age, if the disclosing taxpayer is an individual making a no-names disclosure.
- The taxation years, reporting periods or fiscal periods involved in the disclosure.
- The amount of the disclosure, where applicable.
- The type of returns involved.
- The type of information returns and slips involved.
- The type of omission.
- The reason for the omission.
- The primary business activity.
- An explanation of how the taxpayer considers that each of the CRA's four validity conditions had been satisfied.[82]

(1) Intervening Enforcement Action

If a disclosing taxpayer is the subject of enforcement action subsequent to submitting a disclosure under the VDP, the CRA accepts that the disclosure will not be disqualified on the basis of it not being voluntary solely by virtue of such subsequent action. Accordingly, the date upon which a disclosure is considered to have been made is key to the CRA's determination as to whether the disclosure is valid.

For the purposes of the VDP, the date on which a disclosure is considered to have been made is termed the "effective date of a disclosure" (the "**EDD**"). The CRA considers the EDD to be the earlier of the date the CRA receives a completed and signed Form RC199, and the date the CRA receives a letter, signed by the taxpayer or the taxpayer's authorized representative, which contains information similar to that requested in Form RC199.

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[82] In internally documenting voluntary disclosures, it is instructive to note that the CRA categorizes each voluntary disclosure on the basis of the reason for the disclosure. In particular, the CRA breaks the reasons for disclosures into the following categories:

- Publicity
- Special project
- Outreach program initiative
- Audit action
- Conscience
- Legislative or policy changes
- Death or illness
- Settlement of estate
- Other reasons

The CRA recognizes that taxpayers may be unable to include all necessary information in their initial disclosure. Under such circumstances, the CRA permits taxpayers to submit additional required information and documentation within 90 days of the EDD (the "**Information Period**").[83]

The CRA is open to the possibility of extending the Information Period if the nature of the matters being disclosed are complex, cover a number of periods or programs, or are the subject of "extraordinary circumstances". In such cases, provided a written request is made within 90 days of the EDD, the CRA is generally open to granting an extension of the relevant time period.[84]

To the extent that a taxpayer has not provided the necessary information and documentation to process a disclosure within the Information Period (or such extended period permitted by the CRA), the CRA will generally consider the disclosure to have been withdrawn.[85]

(2) "No-names" Disclosures – The parameters of the program

As previously noted, in recognition of the practical reality that it may not always be clear whether a particular taxpayer's circumstances satisfy the qualifying criteria applied by the CRA in determining whether a disclosure will be eligible for relief under the VDP, the CRA introduced the possibility of taxpayers making a disclosure on a "no-names" basis, through a representative, to gain further insight from the CRA into whether the disclosure would be an eligible voluntary disclosure. The Operations Manual indicates that the "no-names" disclosure process is intended for the benefit of taxpayers "to provide insight into the VDP process, a better understanding of the risks involved in remaining non-compliant, and to explain the relief available under the VDP based on the facts as submitted in the no-names disclosure".[86]

When making a "no-names" disclosure, limited identifying information in respect of the taxpayer is required to be provided to the CRA (i.e., age, gender, first three characters of the taxpayer's postal code). It is understood that this requirement was necessitated by the discovery that certain advisors were making generic "no-names" disclosures without an underlying taxpayer, and thereafter holding such "no-names" disclosures in "inventory" to later be used if a client with past deficiencies, similar to those that had been "disclosed", became subject to audit. The CRA hoped that by requiring limited identifying information to be provided in respect of a taxpayer underlying a "no-names" disclosure, the practice of making "no-names" disclosures, simply to be held for later use, would be curtailed.

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[83] IC00-1R4, *supra* note 17 at para 50.

[84] Operations Manual, *supra* note 18, Officer Section at 1.10.

[85] *Ibid.*

[86] *Ibid* at 6.

The "no-names" disclosure process is intended to provide only a temporary discussion period. The CRA has indicated that a taxpayer is required to reveal his/her/its identity within 90 days of the EDD of a "no-names" disclosure for the disclosure to remain open. The CRA will not grant extensions to such 90-day period, and will consider a voluntary disclosure made on a "no-names" basis to have been withdrawn 90 days after the relevant EDD unless the taxpayer's identity has been revealed.[87]

If a taxpayer has previously made a "no-names" disclosure and did not proceed with the disclosure, the taxpayer will be precluded from subsequently making a second "no-names" disclosure in respect of the same information.[88] Instead, the taxpayer will be required to reveal his/her/its identity at the time of making its second disclosure.[89]

Historically, it was possible for representatives of a taxpayer that made a "no-names" disclosure to have substantive discussions with a VDP officer and receive meaningful feedback on the potential eligibility of the taxpayer to obtain relief under the VDP.

The Operations Manual contemplates a meaningful level of assessment by the CRA of the information disclosed in a "no-names" disclosure, and the provision of some feedback by a responsible VDP officer, prior to the expiry of the applicable 90-day period. In particular, the Operations Manual directs that the VDP Officer is to review all "no-names" disclosures, including the reasons of the taxpayer for disclosing the information in question, and identify any "obvious indication" that the disclosure may not be valid. In addition, the VDP officer is directed to identify any additional information that may be required in order for the officer to conduct his/her preliminary review of the disclosure. In response to each "no-names" disclosure, the Operations Manual contemplates the issuance of a "90-day letter" that sets out a summary of the facts presented, a list of what additional documentation or information may be required to complete the disclosure, and the date the information is due.[90]

In practice, however, the effectiveness of the "no-names" disclosure process has been eroded as the VDP has increased in size. Since the VDP has been centralized in two Taxation Centres, the ability to engage VDP officers in detailed discussions regarding the elements of a "no-names" disclosure has lessened. Contact with VDP officers during the initial, 90-day "no-names" disclosure period is now largely limited to very general discussions with little opportunity for fact-specific analysis and feedback.

The sheer demands placed on the program by the ever-increasing number of voluntary disclosures being made has restricted the CRA's ability to thoroughly review "no-names" disclosures during the initial 90-day period from the EDD. Heightened concerns have also emerged over the possibility that statements made during "no-names" discussions

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[87] IC 00-1R4, *supra* note 17 at para 53.

[88] *Ibid* at para 29.

[89] Quaere how the CRA may be aware of a taxpayer having previously made a "no-names" disclosure prior to revealing his/her/its identity?

[90] Operations Manual, *supra* note 18, Officer Section at 6.5.

between a taxpayer's representative and a VDP officer may limit the subsequent discretion that may be exercised by the CRA. As a result of the foregoing, the "no-names" disclosure process offers less insight than the program did when it was in its infancy 10 years ago, and may well be the subject of further refinement as the CRA undertakes its next periodic review of the VDP.

Processing of Voluntary Disclosures and Administrative Rights of Redress

Upon the review and acceptance of a voluntary disclosure, the CRA advises the taxpayer in writing of the penalties (and potential interest) that may be waived in respect of the disclosure. The file is thereafter sent to either the appropriate processing department or to an applicable division for verification in advance of processing.

In circumstances where the CRA has chosen not to exercise its discretion to grant voluntary disclosure relief under the VDP, the taxpayer is advised of the CRA's decision in writing and offered the opportunity to request a second level administrative review (a "**Second Level Review**") if they believe the Minister has not exercised his/her statutory discretion in a fair and reasonable manner.[91]

A taxpayer must request a Second Level Review in writing by letter addressed to the Assistant Director of the Taxation Centre from which the original VDP decision was issued. The CRA does not impose a deadline by which a request for a Second Level Review must be submitted.[92] While a taxpayer is permitted to make additional factual representations in the course of a Second Level Review, the CRA has indicated that it will not conduct a Second Level Review if the disclosure at issue was denied because information in respect of the disclosure was not submitted within the time frame stipulated by the responsible VDP officer.[93]

A Second Level Review is intended to be an impartial review by an independent representative of the CRA. In this regard, the Operations Manual cautions that the VDP officer(s), team leader, and any other staff member of the CRA that were involved in the initial consideration of the disclosure may not be involved in the Second Level Review.[94]

The Operations Manual specifically directs the CRA delegate conducting a Second Level Review to consider whether (i) all information was considered by the original VDP officer, (ii) certain facts or details were misinterpreted, or not considered in their proper context, by the VDP officer, or (iii) any new facts, documentation, or correspondence are

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[91] IC00-1R4, *supra* note 17 at para 57.

[92] Operations Manual, *supra* note 18, Officer Section at 5.3. Quaere whether the ten-year restriction in subsection 220(3.1) may serve as a practical limitation, notwithstanding that the request for voluntary disclosure relief had previously been submitted to the CRA?

[93] IC00-1R4, *supra* note 17 at para 57.

[94] Operations Manual, *supra* note 18, Officer Section at 5.

now being raised by the taxpayer that may have affected the proper exercise of the Minister's discretion under the VDP.[95]

When conducting a Second Level Review, the Operations Manual directs the responsible CRA officer to consider the following prior to making a determination:

> (d) the contents of the taxpayer's request for a Second Level Review, including the reasons for the request;
>
> (e) the information and documentation presented by the taxpayer to support its request for the Second Level Review;
>
> (f) the contents of the file of the original VDP officer in respect of the disclosure, including the reasons for VDP relief not having been granted;
>
> (g) the record of the decision-making process undertaken by the original VDP officer (to ensure that the review was conducted in a fair and impartial manner);
>
> (h) the substance of the decision rendered by the original VDP officer (to ensure that it was accurate, based on the facts of the case, and was rendered in accordance with applicable legislative provisions).[96]

When reviewing the initial decision that denied voluntary disclosure relief, the officer conducting the Second Level Review is required to (i) isolate the information that was the basis for the initial determination and assess whether it was relevant, (ii) determine whether the initial VDP officer relied on any irrelevant facts, and (iii) determine whether any additional information, submitted in conjunction with the request for the Second Level Review or otherwise, materially alters the factual matrix that underlies the disclosure.[97] (In this regard, the CRA official conducting a Second Level Review is permitted to request additional information that he/she considers necessary to render a full and impartial redetermination.[98])

Judicial Review

In the event that a taxpayer's request for relief under the VDP is denied following both the initial consideration of the taxpayer's disclosure and a Second Level Review, the taxpayer may seek to challenge the CRA's decision not to exercise its discretion in favour of the taxpayer on the basis that either the decision was unreasonable, or that the taxpayer's request had not been considered in a manner that accords with procedural fairness.

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[95] *Ibid* at 5.3.

[96] *Ibid.*

[97] *Ibid* at 5.3.4.

[98] *Ibid* at 5.3.3.

It is critical to note that it lies solely within the CRA's discretion to grant penalty or interest relief to a taxpayer under the VDP, and that the taxpayer is not entitled to any such relief as of right. As a consequence, it is not open to a taxpayer to challenge the CRA's decision not to grant relief under the VDP on the basis that it was not the "correct" decision; rather, a taxpayer may only challenge the exercise of the discretion afforded to the Minister under subsection 220(3.1) on the basis that it was not exercised in accordance with prevailing principles of administrative law.

A request for judicial review of the Minister's decision not to grant voluntary disclosure relief may be made by a taxpayer pursuant to section 18.1 of the *Federal Courts Act*,[99] and must be made within 30 days after the date the taxpayer receives notification that the CRA has chosen not to exercise its discretion to grant relief under the VDP.[100] (The Federal Court is the judicial body responsible for reviewing the administrative conduct of federal agencies. The Tax Court of Canada does not have standing to review exercises of the Minister's statutory discretion granted under subsection 220(3.1).[101])

Since the introduction of the modern VDP, decisions rendered by the Minister to decline to grant relief under the VDP have been challenged in Federal Court in more than 20 cases. The jurisprudence emanating from such disputes provides relatively clear guidance on the means by which the Federal Court will review the exercise of the Minister's discretion under the VDP, and the limited bases upon which the Court may be inclined to find in favour of a taxpayer seeking to challenge the Minister's exercise of such discretion.

(1) Standard of Review

It is settled law that the standard of review to be applied by the Federal Court in reviewing the exercise of the Minister's discretion granted under subsection 220(3.1) is one of "reasonableness".[102] It is not the Court's role, nor does it have the authority, to determine whether the basis for the CRA exercising its delegated discretion in a particular manner was "correct" or was even consistent with the decision that the Court would have reached had it stood in the shoes of the responsible CRA officer. Instead, the sole focus of the Court's inquiry in the context of a judicial review application is on the process by which the Minister's discretion was exercised and whether it yielded a potentially defensible result.[103]

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[99] RSC 1985, c F-7.

[100] *Ibid*, s 18.1(2).

[101] See, for example, *Sifto Canada Corp. v Minister of National Revenue*, 2014 FCA 140 at para 23 [*Sifto Canada*], and *Mazzariol v R*, 2009 TCC 169. This may change in the future as attempts are made to bring the review of exercises of the Minister's statutory discretion within the jurisdiction of the Tax Court of Canada; see, Letter to the Minister of Justice Regarding the Tax Court of Canada, Canadian Bar Association, March 13, 2008.

[102] *Worsfold v Minister of National Revenue*, 2012 FC 644 at para 104 [*Worsfold*].

[103] *Ibid* at para 104.

In *Babin v Canada (Customs and Revenue Agency)*, the Federal Court articulated its role in reviewing the exercise of the Minister's discretion granted under subsection 220(3.1) in the following terms:

> Where a body such as the CCRA is given a broad discretion like that accorded by s. 220(3.1) of the [Tax Act], the deference shown to that body should be broad. The reviewing court should consider whether the discretion was "exercised in good faith and, where required, in accordance with the principles of natural justice, and where reliance has not been placed upon considerations irrelevant or extraneous to the statutory purpose"... If these criteria are properly met, the Court should not interfere. The Court may not substitute its opinion simply because it would have come to a different conclusion...[104]

In describing the practical application of the "reasonableness" standard, the Federal Court has indicated that "[r]eview on this standard requires the Court to ask after a "somewhat probing examination" whether the reasons given for the decision, when taken as a whole, support the decision. The reviewing court is not to ask what the correct decision would have been".[105]

The Federal Court has also had occasion to describe what constitutes an unreasonable exercise of Ministerial discretion that warrants the Court's intervention. With reference to past Supreme Court of Canada jurisprudence, the Federal Court has stated that an unreasonable decision may be characterized as follows:

> An unreasonable decision is one that, in the main, is not supported by any reasons that can stand up to a somewhat probing examination.
>
> When deciding whether an administrative action was unreasonable, the Court should not at any point ask itself what the correct decision would have been.
>
> A decision will be unreasonable only if there is no line of analysis within the given reasons that could reasonably lead the tribunal from the evidence before it to the conclusion at which it arrived. If any of the reasons that are sufficient to support the conclusion are tenable in the sense that they could stand up to a somewhat probing examination, then the decision will not be unreasonable and a reviewing court must not interfere. This means that a decision may satisfy

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[104] 2005 FC 972 at para 15.

[105] *334156 Alberta Ltd. v Minister of National Revenue*, 2006 FC 1133 at para 7.

> the reasonableness standard if it is supported by a tenable explanation even if this explanation is not one that the reviewing court finds compelling. [106]

Ultimately, the Supreme Court of Canada aptly captured the standard of reasonableness to be applied in the context of a judicial review by setting out the required focus of the court in the following terms:

> In judicial review, reasonableness is concerned mostly with the existence of justification, transparency and intelligibility within the decision-making process. But it is also concerned with whether the decision falls within a range of possible, acceptable outcomes which are defensible in respect of the facts and law. [107]

(2) Jurisprudence

In most of the cases in which a taxpayer has challenged the exercise of the Minister's discretion to deny the taxpayer relief under the VDP, the Court has ruled in favour of the Minister. Consistent with the guiding standard of review described above, the Court's focus in such cases has been on whether there is a reasonable factual and logical basis upon which the CRA exercised its discretion to deny voluntary disclosure relief, and whether the process by which the voluntary disclosure was considered accorded with principles of fairness and natural justice.

The majority of cases that have been put before the Federal Court involving the exercise of discretion under the modern VDP have centred on the CRA's determination that the subject disclosure was not "voluntary" because the CRA had previously commenced enforcement action. In determining the standards to be applied in gauging voluntariness, the Court has placed emphasis on both the CRA's published administrative statements, including IC 00-1, and the CRA's internal procedural directives, including the Historical Guidelines. While the Courts have been quick to assert that such statements and internal guidelines do not have the force of law, they have reasoned that they are helpful guidance and useful benchmarks in assessing the process by which discretion has been exercised by the CRA in the particular case before the Court.[108]

Absent clear evidence that the CRA has not considered all of the principal factors relevant to assessing a request for voluntary disclosure relief, with one notable exception, the Courts have been loath to challenge the discretion exercised by the CRA.

In fact, in only five reported cases has the Court directed that the CRA reconsider a disclosure on the basis that its decision was unreasonable.

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[106] *L'Heureux v A.G. of Canada,* 2006 FC 1180 at para 17 citing from *Law Society of New Brunswick v Ryan* [2003] 1 SCR 247.

[107] *Dunsmuir v New Brunswick,* [2008] SCC 9 at para 47.

[108] *Karia, supra* note 44 at para 7; *Poon, supra* note 49 at para 7.

In *Poon*,[109] the applicant taxpayer was a computer consultant and the sole shareholder and president of a corporation known as Application Productivity Services Inc. ("**APS**"). The taxpayer, Mr. Poon, operated his computer consulting business through APS.

Mr. Poon and APS made separate voluntary disclosures. APS disclosed its past failure to report income, potential withholding liabilities, and undisclosed GST liabilities. By contrast, Mr. Poon disclosed his failure to report income earned from APS, remuneration received from other companies (which had been subject to source deductions), gross income from rental property, and investment income.

The CRA declined to grant voluntary disclosure relief to Mr. Poon in respect of his voluntary disclosure on the basis that the CRA had previously contacted him to request that APS file certain outstanding corporate income tax returns. The first level determination made by the original VDP officer was confirmed upon a Second Level Review by the CRA.

Mr. Poon challenged the exercise of the CRA's discretion to deny voluntary disclosure relief before the Federal Court. The Federal Court considered the Historical Guidelines and made specific note of the directive contained therein that the CRA was required to consider not only whether enforcement action had been commenced in respect of a particular person, but also whether it was likely that such enforcement action would have uncovered the information that was the subject of the disclosure.[110]

The file of the CRA officer that conducted the Second Level Review indicated that there had been a complete absence of consideration of whether the enforcement action that had been undertaken in respect of APS would have uncovered the information that was the subject of Mr. Poon's disclosure. The Court concluded that the CRA's exercise of its delegated discretion was unreasonable insofar as it had failed to take account of the critical consideration as to whether the enforcement action initiated in respect of APS would have led to the discovery of Mr. Poon's reported non-compliance.[111] As a consequence, the Court ordered that the disclosure be reconsidered by an independent person at the CRA in a manner that considered all of the required questions indentified in the Historical Guidelines.

In *Amour*, the taxpayer voluntarily disclosed that it had withheld certain amounts under Part XIII of the Tax Act in respect of dividends that it had paid to non-resident shareholders, but that it had failed to remit such amounts to the CRA.[112] The CRA declined to grant the taxpayer voluntary disclosure relief in respect of the disclosure on the basis that enforcement action had already been commenced in respect of an indirect shareholder of the taxpayer that had disposed of shares of the parent corporation of the taxpayer.

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[109] *Poon, supra* note 49.

[110] *Ibid* at para 6.

[111] *Ibid* at para 26.

[112] *Amour, supra* note 55.

The taxpayer challenged the reasonableness of the exercise of the Minister's discretion on the basis that the referenced enforcement action would not have led to an examination of the matters that were the subject of the taxpayer's disclosure.

The Court concluded that there was no evidence to support the proposition that the enforcement action referenced by the Minister, which was being conducted in respect of an indirect shareholder of the taxpayer on a matter completely unrelated to the non-compliance being disclosed by the taxpayer, would have led to the discovery of the failure of the taxpayer to remit Part XIII tax amounts that had previously been withheld.[113] While the CRA led evidence before the Court that internal accounting entries had previously been made in the Agency's records that suggested that the taxpayer should be subject to some form of audit inquiry, the Court summarily concluded that such activities did not represent enforcement action for the purposes of the VDP. On that basis, the Court concluded that the subject disclosure should be referred back to the Minister for redetermination on the basis of a proper consideration of the facts.

Finally, in *Worsfold*, the taxpayer challenged the CRA's decision not to grant voluntary disclosure relief, where the taxpayer submitted a disclosure on the same day that the CRA issued an audit inquiry to a corporation of which the taxpayer was the sole shareholder.[114] The CRA declined to grant voluntary disclosure relief because, in the CRA's view, the enforcement action in respect of the corporation would have uncovered the information being disclosed by the taxpayer.

On judicial review of the CRA's decision, the Federal Court concluded that the taxpayer was not aware of the impending CRA enforcement action in respect of the corporation when he made his disclosure. The Court placed particular weight on the fact that the evidence revealed that the taxpayer's disclosure had been discussed and prepared with the taxpayer's advisors well before the CRA's audit inquiry was made of the corporation.[115] Although the CRA had contacted the secretary of the corporation two days prior to the submission of the taxpayer's voluntary disclosure, the Court concluded that there was no evidence that the taxpayer was aware of such inquiries. On this basis, the Court granted the taxpayer's application and referred the matter back to the Minister for reconsideration.[116]

Outside of the trio of cases referenced above, taxpayers have generally enjoyed little success challenging the discretion of the CRA in declining to grant voluntary disclosure

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[113] *Ibid* at para 24.

[114] *Worsfold, supra* note 102.

[115] *Ibid* at para 115.

[116] It is instructive to note that the decision rendered in *Worsfold* was based on the CRA's published administrative statements in the first revised version of IC 00-1, dated September 30, 2002. The first revised version of IC 00-1 described what the CRA considered to constitute enforcement action in relatively narrow terms. In particular, the Information Circular did not suggest that a mere initiation of enforcement action in respect of a person related to the taxpayer would be sufficient to render a disclosure involuntary, irrespective of whether the taxpayer had knowledge of the enforcement action. Had *Worsfold* been determined on the basis of current CRA administrative policy, it is questionable whether the Court would have reached the same conclusion.

relief. Moreover, challenges of the exercise of the CRA's discretion on the basis that the discretion was not exercised in a manner that accorded with procedural fairness have attracted little sympathy from the Court.[117]

The one exception to the Court's reluctance to disturb the exercise of discretion by the CRA in the context of the VDP relates to circumstances where a taxpayer has been led to believe that the CRA would exercise its delegated discretion in a particular manner, and a decision is subsequently made by the CRA to adopt a different position.

On two occasions in the past, the Federal Court has required the Minister to reconsider a decision made to deny voluntary disclosure relief on the basis that the Minister should be equitably estopped from taking a position contrary to the position conveyed to the taxpayer, either in writing or verbally by the responsible VDP officer.

In *Karia*,[118] the Federal Court held that the Minister was precluded from taking the position that a voluntary disclosure would not be considered to be voluntary on a basis that conflicted with information previously conveyed to the taxpayer in IC 00-1.

In *Karia,* the taxpayer initially made a "no-names" disclosure to the CRA, and received indications from the CRA that his disclosure would be accepted, notwithstanding contemporaneous action by a police force that could potentially have led to the discovery of the information being disclosed. Specifically, the Peel Regional Police had previously executed search warrants on the residence and business of Mr. Karia in connection with a fraud investigation. The next day, the Peel Regional Police referred certain information from their search to the Investigations Division of the CRA. Approximately one month later, counsel for Mr. Karia had a telephone conversation with an officer of the CRA concerning a no-names voluntary disclosure and, consistent with that conversation, thereafter submitted a written disclosure to the CRA on a no-names basis on behalf of Mr. Karia. In the no-names disclosure, counsel to Mr. Karia advised the CRA that his unnamed client had been charged by an unnamed police force "with a minor fraud", and that the investigating officer had mentioned to the taxpayer that the police might notify the CRA that he had failed to report tax payable. Mr. Karia's counsel indicated that (i) the police officer had not made it clear whether such notifications would actually occur or when, and (ii) to the best of his knowledge and the knowledge of his client, no such notification had occurred.

In his no-names submission, Mr. Karia's counsel asked that the CRA confirm that the disclosure would be considered voluntary, despite the disclosed facts, and he requested that the CRA sign and return a copy of the written disclosure to confirm such understanding. The CRA did not confirm the taxpayer's counsel's "understanding" by signing the letter; however, the CRA wrote back to Mr. Karia's counsel and indicated that

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[117] See, for example, *Amour* supra note 55; *Brown v Canada (Customs & Revenue Agency)*, 2005 FC 1639; and *Palonek v Minister of National Revenue,* 2006 FC 494.

[118] *Karia, supra* note 44.

"based on the circumstances described we consider that the disclosure would be valid as presented".[119]

On the basis of the correspondence received from the CRA and its published administrative positions regarding the VDP, Mr. Karia's identity was subsequently revealed to the CRA; yet, notwithstanding its previous correspondence, the CRA ultimately determined that it would not waive the penalties otherwise applicable to Mr. Karia under the VDP on the basis that the disclosure was not voluntary "since it was initiated based on the knowledge of current enforcement activities".[120]

Mr. Karia sought to challenge the reasonableness of the CRA's exercise of its discretion before the Federal Court on the grounds that it was unreasonable for the CRA to exercise its delegated discretion in a manner that did not respect, and give effect to, its previous commitments.

The CRA took the position before the Court that it was entitled to exercise its discretion as stated because, among other things, the then current version of IC 00-1 provided that a disclosure may not qualify as a voluntary disclosure if it was found to have been made with the knowledge of an enforcement action initiated by an authority with which the CRA has an information exchange agreement. By contrast, Mr. Karia contended that, among other things, the Minister should be estopped from taking a position that conflicted with both the written advice previously provided to the taxpayer and the statements made in IC 00-1.

Ultimately, the Court granted Mr. Karia's application by concluding that the requirements of "promissory estoppel" existed in the current case and, therefore, the CRA should be precluded from exercising its discretion in a manner that conflicted with its previous commitments. The Court articulated the test of promissory estoppel as follows:

> Those requirements are that there must be a promise that the promisor will conduct himself in a certain way in certain circumstances. There must be reliance on that promise by the promisee, and to the detriment of the promisee. In such circumstances the promisor will not be allowed to exercise his discretion in a manner inconsistent with the promise, if he otherwise has lawful authority to fulfill that promise. [121]

The Court concluded that the Minister was not entitled to take a position that contradicted its stated position in IC 00-1. In that regard, the Court found that Mr. Karia had no knowledge of an "information exchange agreement" between the CRA and the Peel Regional Police. In fact, the Court questioned whether any such formal agreement

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[119] *Ibid* at para 4.

[120] *Ibid.*

[121] *Ibid* at para 9.

existed. As a consequence, the Court held that it was unreasonable for the Minister to assess whether Mr. Karia's disclosure was voluntary on a basis that conflicted with the test set out in IC 00-1. Accordingly, the Court referred the matter back to the Minister to be assessed on the basis that the disclosure should be treated as voluntary.

Similarly, in *Wong*,[122] the taxpayer had contacted a representative of the CRA to inquire about the possibility of making a voluntary disclosure, despite the fact that he had been advised that his GST return for the first quarter of 2005 had been selected for audit. Mr. Wong was informed that he was not eligible to make a voluntary disclosure in respect of his 2005 taxation year because there was an audit ongoing. However, Mr. Wong testified that he understood from the nature and content of his discussions with the CRA that he would be eligible to make a voluntary disclosure in respect of his taxation years other than 2005. In this regard, Mr. Wong led affidavit evidence before the Federal Court that indicated that the representative of the CRA he spoke with had indicated that making a voluntary disclosure for periods prior to 2005 would be "okay".[123]

Notwithstanding its previous verbal assurances, the CRA subsequently denied Mr. Wong's request for voluntary disclosure relief for periods prior to 2005.

Mr. Wong challenged the reasonableness of the exercise of the Minister's discretion on the basis that due weight had not been given to the fact that Mr. Wong had made his voluntary disclosure on the basis of assurances received from the CRA that it would be acceptable. The Court made particular note of the fact that Mr. Wong had several meetings and discussions with CRA officials subsequent to the submission of his voluntary disclosure during which the CRA never raised possible concerns with whether his disclosure would be considered to be voluntary.[124]

On the basis of the Court's previous judgment in *Karia*, the Court held that the Minister was estopped from taking the position that Mr. Wong's disclosure was not voluntary on account of the CRA's previous GST enforcement activities since he had been led to believe by an official of the CRA that such enforcement action would not preclude a voluntary disclosure from being accepted in respect of his prior taxation years.

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It is instructive to note that the rate at which cases are being argued before the Federal Court relating to the exercise of the Minister's discretion under the VDP has declined in recent years.[125] This decline potentially reflects a maturity in the jurisprudence, and the

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[122] *Wong v Minister of National Revenue*, 2007 FC 628 [*Wong*].

[123] *Ibid* at para 13.

[124] *Ibid* at para 17.

[125] In addition to the decisions cited herein, the judgment of the Federal Court of Appeal in *Sifto Canada* (which focused on the Minister's attempt to quash an application for judicial review of the Minister's decision to deny penalty relief under the VDP after an agreement had purportedly been reached with the taxpayer) stands as a further example of an instance where the Court signaled a willingness to carefully examine the impact of commitments made by the CRA on the exercise of its discretion granted under subsection 220(3.1).

impact of both heightened efforts on the part of the CRA to broaden the description of its discretion in its published administrative statements and the increased reluctance of VDP officers to make commitments to taxpayers that can subsequently form the basis for an assertion of equitable estoppel.

Deductibility of Fees to Pursue a Voluntary Disclosure

The deductibility of advisor fees incurred to prepare and pursue a voluntary disclosure has long been a topic of debate among tax practitioners. The CRA has consistently taken the view that legal fees incurred to prepare an application for voluntary disclosure relief, and thereafter negotiate its acceptance, are not deductible under paragraph 60(o), despite the flexibility that the CRA has appeared to exercise in applying the paragraph in other contexts, including in respect of fees incurred to respond to CRA audit inquiries.[126] The CRA has further asserted that such fees are not deductible under section 9 on the basis that legal expenses incurred with respect to a voluntary disclosure are not incurred to earn income from a business or property.[127] However, where a disclosing taxpayer earns income from a business, the CRA has suggested that legal fees incurred in making a voluntary disclosure relating to the business may be deductible as a cost of representation under paragraph 20(1)(cc).[128] In addition, once a voluntary disclosure has been accepted, the CRA permits the deduction of legal fees incurred in respect of the determination of the taxpayer's consequential tax liability.[129]

The VDP: What's Next?

Clues as to the future evolution of the VDP can arguably be drawn from the development of the federal VDP over the past 45 years.

Initially, the federal government was willing to administer a robust voluntary disclosure program that granted the federal tax department broad discretion to waive penalties. Over time, the breadth of the penalty relief offered by Revenue Canada began to narrow. Then, suddenly, the orientation of the program began to change with the introduction of Information Circular 85-1R2, resulting in the scope of relief offered under the VDP again expanding. In retrospect, the orientation of the VDP has followed a cyclical pattern.

The increasing size of the VDP, and potential scrutiny of the amount of penalties being waived under the program, may again stimulate a shift in the orientation of the program. The federal government's recent decision not to offer voluntary disclosure relief to those named in the "Panama Papers" may serve as an advance indication of the increasing influence that external pressures may bear on the relief offered under the VDP. With the more fulsome pursuit by the government of the initiatives contemplated by BEPS, and the

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[126] See, for example, CRA, Technical Interpretation Letters #2016-0625731C6 (January 21, 2016), #2014,0528451C6 (May 22, 2014), and #2012-0437831E5 (June 5, 2012).

[127] See, for example, CRA, Technical Interpretation Letter #2012-0437831E5 (June 5, 2012).

[128] See, for example, CRA, Technical Interpretation Letter #2016-0625731C6 (January 21, 2016).

[129] See, for example, CRA, Technical Interpretation Letters #2016-0625731C6 (January 21, 2016) and #2012-0437831E5 (February 6, 2012).

increasing availability of information from foreign revenue authorities, the ability of taxpayers to avail themselves of the relief offered under the VDP in respect of income earned, and property held, offshore may also be attenuated in the future.

Recent amendments to the CRA's written directives relating to the VDP have, in many respects, made such documents less definitive when setting out the parameters guiding the exercise of the CRA's discretion in administering the VDP. It is instructive to note that such changes have frequently followed adverse judgments rendered by the Federal Court in response to taxpayers challenging the CRA's exercise of its discretion under the VDP.

Perhaps the greatest challenge facing the CRA in guiding the future development of the VDP relates to the management of the "no-names" disclosure process. The concerns expressed by tax advisors as to the types of discussions that may now be had with VDP officers in the context of a "no-names" disclosure will certainly be a matter of focus among senior officials at the CRA. The practical challenge that the CRA will face is the degree to which it is willing to empower its VDP officers to make commitments to taxpayers at the "no-names" disclosure stage that could potentially preclude the CRA from exercising its discretion in a particular manner in the future.

Ultimately, the CRA has much to be proud of in reflecting on the growth and engagement of the VDP. Taxpayer awareness of the program is constantly increasing, and heightened levels of compliance are flowing naturally from the opportunity for taxpayers to correct past tax deficiencies in a meaningful and feasible manner.

No doubt the CRA will be carefully reflecting on the best way to facilitate the future expansion of the VDP over the coming years in a manner that will properly balance the competing pressures that will continue to pit the interests of promoting greater levels of compliance against properly holding taxpayers to account for the implications of their past non-compliance.

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Michael regularly counsels investment funds and asset managers on the establishment and administration of tax-efficient investment vehicles. Michael also advises clients on the taxation and efficient structuring of hedging transactions, derivative instruments, securities lending arrangements, and repo transactions.

Michael has broad experience, and has enjoyed great success, representing clients in resolving tax disputes with both the Canada Revenue Agency and the provincial revenue authorities. He has appeared before both the Tax Court of Canada and the Federal Court of Appeal.

Michael has been frequently quoted in the national print media and has appeared on the Business News Network, the CTV News Channel, the CTV National News, and TVO to discuss taxation matters.