

VOLUNTARY DISCLOSURES - PART I

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on the rules relating to the tax treatment of Voluntary Disclosures. Alpert Law Firm is experienced in providing legal services to its clients in tax dispute resolution and tax litigation, tax and estate planning matters, corporate-commercial transactions and estate administration. Howard Alpert has been certified by the Law Society as a Specialist in Estates and Trusts Law, and also as a Specialist in Corporate and Commercial Law.

A. THE VOLUNTARY DISCLOSURES PROGRAM

Pursuant to subsection 220(3.1) of the *Income Tax Act* (“Act”), the Canada Revenue Agency (“CRA”) has wide discretion to give equitable relief to a taxpayer accepted into the Voluntary Disclosures Program (“VDP”) by waiving penalties and interest that would otherwise be payable under the Act. A taxpayer may also receive relief from prosecution. On December 15, 2017, the CRA issued Information Circular IC00-1R6 entitled “Voluntary Disclosures Program” outlining a program for taxpayers to make an application to correct inaccurate or incomplete information, or to disclose information not previously reported. A “taxpayer” in the context of the VDP includes an individual, an employer, a corporation, a partnership or a trust. This program applies to disclosures made after March 1, 2018.

The Minister’s ability to grant interest and penalty relief under the VDP is limited to any taxation year that ended within the previous 10 years before the calendar year in which the application is filed. However, interest relief may be granted in respect of interest that accrued during the 10 previous years before the calendar year in which the application is filed, regardless of the taxation year in which the tax debt originally arose. There is no limitation period applicable to the ability of the Minister to examine unreported income. The Minister can assess back taxes, interest and penalties for an infinite number of years, while only offering relief from interest and penalties for the most recent 10 years.

Similar voluntary disclosure provisions are available pursuant to: (i) section 88 and section 281.1 of the *Excise Tax Act*; (ii) section 173 and section 255.1 of the *Excise Act, 2001*; (iii) section 30 and section 55 of the *Air Travelers Security Charge Act*; and (iv) section 37 of the *Softwood Lumber Products Export Charge Act*. In addition, the Ontario Ministry of Finance has a similar voluntary disclosure program for certain provincial taxation statutes.

B. TAXPAYER REMEDIES**(1) SECOND LEVEL REVIEW**

If the Minister finds that a taxpayer's submission does not satisfy all five conditions of the federal VDP, as set out in section D of this Legal Business Report, a taxpayer may request an internal second level review of the original decision for fairness and reasonableness by the Assistant Director of the Shawinigan National Verification and Collections Centre. The taxpayer may make additional representations to the CRA at this time. The CRA will not consider a request for a second review if an application was denied because the information previously requested was not submitted within the stipulated time frame.

(2) JUDICIAL REVIEW

Alternatively, where a taxpayer believes that the Minister did not exercise its discretion in a fair and reasonable manner during the review, the taxpayer may apply to the Federal Court for judicial review of the Minister's decision within 30 days of being notified of the decision. The taxpayer must seek a second level review before applying for judicial review. The Federal Court will review the Minister's discretionary power on a standard of reasonableness based on whether the Minister's decision falls within a range of reasonable outcomes. The Federal Court will not overturn a decision made by the Minister.

In the event that the Federal Court rules that the Minister did not exercise its discretion in a fair and reasonable manner, the Federal Court can set aside the Minister's decision and refer the matter back to the CRA for determination in accordance with directions from the Court. The Federal Court can also order the Minister to perform an act that the Minister has unlawfully failed or refused to do, or has unreasonably delayed in doing. If a Federal Court judge determines that a new review is to be conducted by the Minister, the Minister's subsequent review can also be the subject of a new application to the Federal Court for judicial review.

(3) NOTICES OF OBJECTION

A taxpayer is now prohibited from filing an objection to dispute the assessment of penalties and interest made with respect to the VDP application. Further, under the Limited Subprogram, the taxpayer is required to waive his rights to object and appeal in relation to the specific matter disclosed in the VDP application and any related tax assessments. Under the Limited Subprogram, a taxpayer is limited to filing a Notice of Objection in circumstances where: (i) the assessment includes a calculation error; (ii)

relates to a characterization issue (such as income versus capital gain treatment); or (iii) relates to an issue other than the matter disclosed in the VDP application.

C. INFORMATION/DOCUMENTATION REQUIRED

Taxpayers should use Form RC199, Voluntary Disclosure Program (VDP) Application to apply. If the taxpayer is not using the Form RC199, the application should contain all the information requested on that form. All CRA returns, forms and schedules needed to correct the non-compliance must be included in the application.

If an advisor assisted the taxpayer in respect of the subject matter of the VDP application, the name of that advisor should be included in the application. The CRA will likely use this information to focus audits on certain tax professionals.

While the VDP application is being evaluated, the CRA may request additional documentation including: (i) records; (ii) books of accounts; (iii) names of financial advisers; and (iv) other specific documentation, such as information relating to foreign accounts, assets and financial institutions. A taxpayer must comply with these requests within the allowed timeframe and provide sufficient detail to verify the facts of the case. If a taxpayer refuses to provide complete documentation or if the CRA is not satisfied with the completeness of the application, the taxpayer will most likely not be eligible for relief.

Applications involving complex issues or large dollar amounts will be reviewed for completeness by a specialist prior to the VDP application being accepted.

D. CONDITIONS FOR VALID VOLUNTARY DISCLOSURE

The taxpayer is required to initiate the voluntary disclosure. Alternatively, a taxpayer's authorized representative can make the voluntary disclosure on behalf of the taxpayer if both the taxpayer and the authorized representative sign the VDP application. The taxpayer must grant prior authorization to the representative by submitting a signed copy of the appropriate authorization form. A copy of the authorization should be attached to the VDP application. A VDP application must meet five conditions to qualify for relief.

(1) DISCLOSURE MUST BE VOLUNTARY

A disclosure will not be considered to be voluntary if: (i) the taxpayer was aware of, or had knowledge of a future enforcement action with respect to the information being disclosed to the CRA; (ii) an enforcement action relating to the subject matter of the VDP application has been initiated against the taxpayer, a person associated with,

or related to the taxpayer (i.e. this includes, but is not restricted to, corporations, shareholders, spouses and partners); or (iii) an enforcement action relating to the subject matter of the VDP application has been initiated against a third party, where the purpose and impact of the enforcement action against the third party is sufficiently related to the present application; or (iv) the CRA has already received information regarding the taxpayer's (or a related taxpayer's) potential involvement in non-compliance (e.g. a leak of offshore banking or other information that names the taxpayer).

An enforcement action may include, but is not limited to: (i) an audit, examination, investigation or other enforcement action by the CRA or any other authority or administration, such as a federal or provincial authority, a law enforcement agency, or a securities commission; (ii) requests, demands or requirements issued by the CRA, relating to unfiled returns, unremitted taxes, deductions required at source. Although these actions may only pertain to one specific year, the procedure will be considered an enforcement action for all taxation years; (iii) requests, demands or requirements which have been issued with reference to other tax affairs of the taxpayer, partners of the taxpayer, trusts in which the taxpayer is a settlor, trustee or beneficiary, or corporations associated with or related to the taxpayer; and/or (iv) direct contact by a CRA employee for any reason relating to non-compliance (e.g. unfiled returns, audit, collection issues).

Not all CRA initiated enforcement action may cause a VDP application to be denied. To be denied, there must be correlation between the tax issue being disclosed in the VDP and the tax issue related to the enforcement action. For example, there may not be sufficient correlation between a GST/HST issue and a source deductions issue to deny a VDP application. A letter from the CRA inviting the taxpayer to correct their tax affairs will not be considered an enforcement action, but it may result in the application being considered under the Limited Subprogram, which is discussed below.

The confirmation of the voluntary status of disclosure will only take place after all the information, including the identity of the taxpayer, is provided to the CRA.

The existence of a computer-generated notice from the CRA is considered to be an enforcement action by the CRA under Information Circular IC00-1R3 entitled "Voluntary Disclosures Program" (IC00-1R3). Therefore, its existence may disqualify the disclosure from being voluntary, unless it can be demonstrated that the taxpayer did not receive the computer-generated notice or that enough time has passed to suggest that the enforcement action had in effect been abandoned by the CRA.

(2) DISCLOSURE MUST BE COMPLETE

The taxpayer must fully disclose all inaccurate, incomplete or unreported information, including any non-arm's length transactions and circumstances, for all non-compliant taxation years, even those years that fall outside the 10 year limitation period for relief. If books and records no longer exist, the taxpayer should make all reasonable efforts to estimate the income for those years. For example, if a taxpayer opened an offshore bank account in 2000, but records only exist for 2007 to 2015, then the taxpayer should estimate the unreported pre-tax earnings that were deposited during that time and the interest earned.

In extraordinary circumstances, the CRA may allow the taxpayer additional time to submit information in order to complete the application. This extension is normally no more than 90 days from the effective date of disclosure. The taxpayer must request for an additional specified period of time in writing at the time the application is submitted for the CRA to consider it.

The disclosing taxpayer may not be disqualified simply because the disclosure contains minor errors or omissions. However, if the disclosure is found to contain material errors or omissions, the disclosure will not qualify for the VDP.

The taxpayer will be held to the reasonable person standard and the disclosure must be substantially complete. If the CRA is satisfied that the taxpayer has provided all available information and legitimately cannot locate or obtain certain documents (e.g. relating to deceased relatives) or has made reasonable efforts to estimate income amounts related to years for which documentation is unavailable, the application may be considered to be complete. Where a disclosure is found to be incomplete, the taxpayer's disclosed information will be processed in the normal course by the CRA and the taxpayer will be exposed to interest and penalties on the entire outstanding amount, as well as potential prosecution. The taxpayer may also be exposed to these liabilities if the CRA did not receive the requested documentation or information within the stipulated time frame. The CRA reserves the discretion to commence enforcement action and subsequent prosecution in these cases. The CRA may also request documentation to verify amounts disclosed.

(3) DISCLOSURE MUST INVOLVE AN INCOME TAX PENALTY

The penalty may be a late-filing penalty, a failure to remit penalty, an installment penalty, or a discretionary penalty, such as an omission penalty or a gross negligence penalty. Where there is no monetary penalty involved, the information can be submitted to the CRA in the normal manner and there is no need for a taxpayer to disclose information through the VDP. The VDP may also be used by a taxpayer to seek relief

for penalties imposed for the late filing of forms, in addition to penalties and interest for failure to pay income taxes and fraud.

(4) DISCLOSURE OF OVERDUE INFORMATION

The disclosure must involve information that is at least one year or more overdue. Where a voluntary disclosure relates to the current taxation year, it will qualify for the VDP only where it is submitted as part of a disclosure for a series of years, where it corrects a previously filed return, or where the disclosure contains information that is itself at least one year past due.

(5) DISCLOSURE MUST INCLUDE PAYMENT OF ESTIMATED TAX OWING

Valid disclosures must include payment of the estimated tax owing at the time the application is filed. If the taxpayer is unable to make the payment, arrangements with the CRA may be allowed in some circumstances. The taxpayer will have to make full disclosure and provide evidence of income, expenses, assets, and liabilities supporting the inability to make payment in full. In some cases, the payment arrangement will need to be supported by adequate security.

This issue of the Legal Business Report is designed to provide information of a general nature only and is not intended to provide professional legal advice. The information contained in this Legal Business Report should not be acted upon without the further consultation with professional advisers.

Please contact Howard Alpert directly at (416) 923-0809 if you require assistance with tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions or estate administration.

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