

# FEDERAL GOVERNMENT PROPOSES FUNDAMENTAL CHANGES TO THE VOLUNTARY DISCLOSURES PROGRAM

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On June 9, 2017, the Canada Revenue Agency (the “CRA”) confirmed that it intends to dramatically narrow the circumstances under which taxpayers may obtain relief from penalties and interest under the CRA’s Voluntary Disclosures Program (the “VDP”).

The details of the CRA’s plan to fundamentally restructure the VDP are set out in a revised draft of its [Information Circular - IC00-1R6 – Voluntary Disclosures Program](#) (the “**New Circular**”), which the CRA has released for public comment. The revised rules reflected in the New Circular are proposed to take effect at the beginning of 2018 and will replace the administrative policies that currently govern the program. Taxpayers with outstanding tax deficiencies should carefully consider making a disclosure under the VDP before access to the program is restricted at the end of 2017.

The New Circular only addresses voluntary disclosures made under the *Income Tax Act* (Canada) (the “**Tax Act**”). The CRA has also released [Draft GST/HST Memorandum 16.5 – Voluntary Disclosures Program](#), which outlines the CRA’s new policies for voluntary disclosures involving the Goods and Services Tax and the Harmonized Sales Tax, excise tax, excise duty, the softwood lumber products export charge and the air travelers security charge (the “Draft Memorandum”). We have prepared a bulletin discussing the [Draft Memorandum](#).

Unless otherwise specified, the discussion below relates only to voluntary disclosures made under the Tax Act.

## Background

The purpose of the VDP is to promote voluntary compliance with Canada’s tax laws by encouraging taxpayers to come forward and correct inaccuracies or omissions in their past reporting to the CRA. Where an eligible taxpayer makes a valid disclosure, the taxpayer is required to pay all outstanding taxes and some interest, but will not be liable for penalties, or be subject to prosecution, under the Tax Act.

The VDP has been an extremely popular program, providing taxpayers with a pragmatic means of addressing past omissions and deficiencies. In its 2016 annual report to Parliament, the CRA indicated that [the number of](#)

[disclosures made under the VDP had increased by 21% over the prior year](#), and that more than \$1.3 billion of unreported income had been voluntarily disclosed under the VDP.

In April 2016, the Minister of National Revenue (the "**Minister**") announced the creation of an independent advisory panel, the Offshore Compliance Advisory Committee (the "**OCAC**"), to provide the Minister and the CRA with guidance on how to better address offshore tax evasion and aggressive tax planning. Despite the VDP's resounding success, in October 2016, the House of Commons Standing Committee on Finance recommended that the CRA conduct a comprehensive review of the VDP. In December 2016, the OCAC presented a report on the VDP to the Minister. [The OCAC report endorsed the continuation of the VDP, but suggested measures that would materially limit access to the VDP](#) and reduce relief to taxpayers who deliberately and wilfully evade taxes. The proposed changes to the VDP reflected in the New Circular (the "**New VDP Policies**") are a direct result of this process.

## **The Current VDP**

The elements of the [current VDP](#) are well established.

## **Changes Proposed in the New Circular**

Generally, the New VDP Policies will have the effect of:

- narrowing eligibility for relief under the VDP;
- imposing additional conditions on applicants for VDP relief; and
- offering less generous relief in certain circumstances.

### *Introduction of the new two-track eligibility system*

Currently, taxpayers making a disclosure under the VDP are subject to the same assessment criteria and, irrespective of their specific circumstances, are potentially eligible for the same relief under the VDP.

The CRA is now proposing to create a two-track eligibility system, consisting of both (i) a "General Program", and (ii) a "Limited Program".

Applications that qualify for inclusion under the VDP's "General Program" will continue to be eligible for exemption from criminal prosecution for tax offences, as well as penalty relief and partial interest relief (in a manner consistent with the current parameters at the VDP).

By contrast, applications that disclose "major non-compliance" will be processed under the VDP's "Limited Program". According to the CRA, "major non-compliance" will include:

- active efforts to avoid detection through the use of offshore vehicles;

- non-compliance involving large dollar amounts;
- multiple years of non-compliance;
- non-compliance by a sophisticated taxpayer;
- non-compliance that is disclosed after the release of an official CRA statement announcing a new focus of CRA enforcement activity, the issuance of CRA correspondence[1], or the
- commencement of a CRA “campaign”; and
- any other circumstance where a high degree of taxpayer culpability contributed to the failure to comply.

A taxpayer that makes a valid disclosure under the “Limited Program” will not be referred for criminal prosecution with respect to the disclosure and will not be charged a gross negligence penalty. However, the taxpayer will be liable for any other penalties levied under the Tax Act and will not be eligible for interest relief.

Applications processed under the “Limited Program” will be referred for review for completeness by a CRA specialist prior to the application being accepted, thereby prolonging the VDP process and activating broader scrutiny of a taxpayer’s past affairs.

In addition, in consideration for the relief provided under the “Limited Program”, a taxpayer will be required to waive his/her further right to object to the specific matter disclosed in the VDP application and any specifically related assessment of taxes.

#### *Replacement of the “No-Names” disclosure program*

Under the current VDP, taxpayers reluctant to proceed with a disclosure are ostensibly afforded the opportunity to participate in preliminary discussions with the CRA on a “no-names” basis.

The “no-names” process is initiated by providing preliminary information in writing to the CRA setting out the taxpayer’s situation without disclosing the taxpayer’s name. If the applicable eligibility criteria for a valid voluntary disclosure are met based on the information provided, a VDP officer may confirm that the application is not disqualified under the VDP.

The “no-names” process provides taxpayers with a degree of comfort that they are eligible for relief under the VDP before proceeding with a disclosure.

When a taxpayer makes a “no-names” voluntary disclosure, the taxpayer’s eligibility for relief under the VDP will not be compromised if an audit of the taxpayer is subsequently commenced after the “no-names” disclosure is made, but prior to the expiry of the 90 day period in which “no-names” discussions with CRA are permitted to take place.

The New VDP Policies will replace the “no-names” disclosure process with a “pre-disclosure discussion” process,

which will accommodate a general discussion of a taxpayer's circumstances with a CRA officer, in an informal and non-binding manner. However, such discussions will not provide any form of confirmation that a disclosure is not per se disqualified from eligibility for VDP relief, or whether the disclosure will fall within a particular "track", nor will it provide a period in which the disclosing taxpayer's ability to secure relief under the VDP will be preserved while the taxpayer considers whether to proceed with a disclosure.

#### *Expanded list of circumstances where relief will not be considered*

The New Circular expands on the current list of circumstances under which applications under the VDP will not be accepted.

Most notably, the New VDP Policies will preclude corporations with gross revenue in excess of \$250 million in at least two of its last five taxation years from making a disclosure under the VDP. In addition, applications for relief in respect of transfer pricing adjustments or penalties under section 247 of the Tax Act will no longer be permitted under the VDP.

Finally, the New VDP Policies will preclude applications from being made under the VDP that rely on an agreement made at the discretion of the Canadian competent authority under a tax treaty.

#### *Changes to conditions for a valid disclosure*

Under the current VDP, a disclosure will be considered valid if it is (i) voluntary, (ii) complete, (iii) involves the application or potential application of a penalty, and (iv) includes information that is at least one year past due.

In the New Circular, the CRA is proposing to introduce an additional condition that will require taxpayers to include a payment of the estimated tax owing with their VDP application. (A payment arrangement supported by adequate security may be available to taxpayers in extraordinary circumstances who are unable to make the required payment in full, and can provide supporting evidence for such inability).

On a positive note, the New VDP Policies appear to slightly relax the criteria in determining what constitutes a complete disclosure. Under the current VDP, a taxpayer is required to provide full and accurate facts and documentation for all taxation years or reporting periods where there was previously inaccurate, incomplete or unreported information. Under the New VDP Policies, an application may be considered complete if the CRA is satisfied that the taxpayer has provided all available information and legitimately cannot locate or obtain certain documents, or has made reasonable efforts to estimate income amounts related to years for which documentation is unavailable.

#### *Disclosure of advisors*

The New VDP Policies also require that where a taxpayer has received assistance from an advisor in respect of

the subject matter of a VDP application, the name of that advisor will generally be required to be included in the application.

A taxpayer's authorized representative (who is commonly also the taxpayer's advisor) will also be required to sign Form RC199 *Voluntary Disclosures Program (VDP) Taxpayer Agreement*, which is required to be submitted as part of the voluntary disclosure process.

#### *Cancellation of relief for misrepresentations*

The New VDP Policies also provide the CRA with the power to cancel previously issued VDP relief where it is subsequently discovered that a taxpayer's application contained any misrepresentation attributable to neglect, carelessness, wilful default, or fraud.

#### *Reduction in interest relief*

Finally, under the current VDP, a valid disclosure entitles the taxpayer to partial interest relief in respect of assessment for years preceding the three most recent years of returns required to be filed. Full interest charges are assessed for the three most recent years. The New VDP Policies will result in potentially available interest relief being reduced to 50 per cent of the applicable interest for years preceding the three most recent years.

### **Conclusions**

The New VDP Policies will limit access to the VDP, reduce the relief available to taxpayers, and generally increase the scope of the Minister's discretion to accept or reject applications made under the VDP.

Of particular note to multinational enterprises are the carve-outs from the VDP. Corporations with gross revenue in excess of \$250 million in at least two of the last five taxation years will be precluded from making an application under the VDP. Also excluded are applications dealing with transfer pricing adjustments or penalties under section 247 of the Tax Act.

The effective elimination of the "no-names" disclosure process will also reduce the effectiveness of the VDP. Prior to the introduction of the "no-names" disclosure process, taxpayers were able to draw some helpful guidance from a "pre-disclosure discussion". However, over time, the generic nature of such pre-disclosure discussions rendered them unhelpful to taxpayers contemplating a voluntary disclosure. The introduction of the "no-names" disclosure process provided taxpayers with the requisite confidence to proceed with certain disclosures. It is unlikely that the reversion to the "pre-disclosure discussion" approach will be an effective replacement for the "no-names" disclosure process.

Overall, New VDP Policies will likely result in a reduced number of voluntary disclosures, and a corresponding drop in taxes raised, under the VDP.

Taxpayers that are contemplating a potential voluntary disclosure, especially one involving cross-border matters, should carefully consider initiating such a disclosure at the earliest opportunity to avoid the possibility of being precluded from making such a disclosure by changes proposed to take effect in 2018.

### **Next Steps**

The CRA is accepting public comments on the New VDP Policies contained in the New Circular until August 8, 2017. This includes specific feedback on the following three questions related to the VDP:

- Is the VDP the appropriate mechanism for taxpayers to fix mistakes?
- Should the VDP apply exclusively to taxpayers who knowingly choose not to pay their taxes, or also to those who make mistakes on their returns?
- With the New VDP Policies, has the CRA achieved a balance between helping fully compliant taxpayers and having appropriate consequences for those who seriously broke the rules?

Following the designated comment period, the CRA has indicated it will officially announce changes to the VDP in fall of 2017, with an expected coming into force in 2018.

by Michael Friedman, Ehsan Wahidie and Patrick Brousseau, Summer Law Student

[1] In 2010, the CRA began yearly letter campaigns to inform select taxpayers about their tax obligations and to encourage them to correct any inaccuracies in their past income tax returns. These letters were intended to be educational letters to encourage voluntary tax compliance. In fact, the letters generally invited taxpayers to consider correcting past deficiencies through the VDP. It is unclear whether the underlying purpose or orientation of the letter campaign will change as a result of the issuance of the New Circular.[ps2id id="1" target=""]

### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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