THE CANADA REVENUE AGENCY PROPOSES DRAFT MEMORANDUM FOR VOLUNTARY DISCLOSURES INVOLVING GST/HST AND OTHER EXCISE TAX MATTERS

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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 ("**VDP**").

The details of the CRA's plans to fundamentally restructure the VDP are set out in two draft publications: *Information Circular – IC00-1R6 – Voluntary Disclosures Program* (the "**Draft Circular**") and *Draft GST/HST Memorandum 16.5 – Voluntary Disclosures Program* (the "**Draft Memorandum**"). Both of these publications have been released for public comment through an online consultation process. 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.

Currently, voluntary disclosures under the various federal taxation statutes are governed by *Information Circular – IC00-1R5 – Voluntary Disclosures Program* (the "**Current VDP**"). The proposed changes will see voluntary disclosures under the *Income Tax Act* (Canada) (the "Income Tax Act") handled in accordance with policies in the Draft Circular, whereas disclosures relating to goods and services tax and the harmonized sales tax ("**GST/HST**"), excise tax, excise duty, softwood lumber products export charge and air travellers security charge handled in accordance with policies in the Draft Memorandum. We have prepared a bulletin discussing the Draft Circular.

Unless otherwise specified, the discussion below relates only to voluntary disclosures that will be governed by the Draft Memorandum (the "**Proposed Changes**").

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 generally required to pay all outstanding taxes and some

interest, but will not be liable for penalties, or be subject to prosecution, under the relevant taxation statute. Under the Current VDP, interest relief may be available in limited circumstances, notably for GST/HST "wash transactions" (discussed further below).

The VDP has historically served as 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 further 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.

While the measures suggested in the OCAC report were targeted towards voluntary disclosures under the Income Tax Act, the CRA has taken the opportunity to bifurcate the voluntary disclosures process into disclosures under the Income Tax Act and those involving disclosures under the various other tax and fiscal statutes (except customs, which is governed by the Canada Border Services Agency's *Memorandum D11-6-4 - Relief of Interest and/or Penalties Including Voluntary Disclosure*). The changes proposed in the Draft Memorandum are an offshoot of these review processes.

The Current VDP

The elements of the Current VDP are well established.

Changes Proposed in the Draft Memorandum

Generally, the Proposed Changes 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 three-track eligibility system

Currently, taxpayers making a disclosure under the VDP are generally subject to the same assessment criteria,

and are eligible for the same potential relief, as any other taxpayer making a disclosure under the Current VDP (subject to the notable exception of GST/HST wash transactions). However, the CRA is now proposing to create a new three-track eligibility system, consisting of (i) a "GST/HST Wash Transactions", (ii) a "General Program", and (iii) a "Limited Program". The extent of the relief available to a taxpayer under the VDP will be based on a variety of factors, including the degree of purported culpability for the non-compliance disclosed.

Track 1 GST/HST wash transactions

Track 1 will provide relief for applications involving GST/HST "wash transactions" that are eligible for reduction of penalties and interest under the policy set out in GST/HST Memorandum 16.3.1, Reduction of Penalty and Interest in Wash Transaction Situations. A wash transaction eligible for this relief occurs when (i) a registrant supplier has made a taxable (other than a zero-rated) supply, (ii) the registrant supplier has not charged, collected and reported the GST/HST, and (iii) had the supplier charged the GST/HST to the registrant customer, as required, the customer would have been entitled to claim an input tax credit ("**ITC**") to fully recover the tax charged.

A wash transaction may also occur where tax is collected and reported (or ITCs claimed) by the wrong entity within a closely related group, or between associated persons, all of whom are engaged exclusively in taxable commercial activities.

Under the Proposed Changes, applicants accepted into Track 1 would be eligible for 100% penalty and interest relief (the same as under the Current VDP), and the registrant will not be referred for criminal prosecution with respect to the disclosure.

Track 2 General program

Track 2 will provide relief for applications disclosing non-compliance or errors, including:

- GST/HST wash transactions not covered by Track 1;
- reasonable errors;
- failure to file information returns;
- no gross negligence or deliberate avoidance of tax; and
- over-claimed rebates.

Under the Proposed Changes, applicants accepted into Track 2 would be eligible for 100% penalty relief and 50% interest relief, and the registrant will not be referred for criminal prosecution with respect to the disclosure.

Track 3 Limited program

Track 3 provides limited relief for applications disclosing major non-compliance, including those with:

- GST/HST charged or collected but not remitted;
- active efforts to avoid detection (for example, persons involved with the underground economy);
- large dollar amounts;
- multiple years of non-compliance;
- a sophisticated registrant;
- disclosures made after an official CRA statement regarding its intended focus of compliance, or following CRA educational correspondence[1] or campaigns, which cover the taxpayer's activity, industry or non-compliance;
- deliberate or wilful default or carelessness amounting to gross negligence; and
- any other circumstance where a high degree of registrant culpability contributed to the failure to comply.

Unlike the Draft Circular, the changes proposed in the Draft Memorandum do not preclude applications for disclosures from corporations with gross revenue in excess of $250 million in at least two of the last five taxation years, provided that the application does not relate to a tax election. Query whether such taxpayers would nevertheless be considered sophisticated by CRA and precluded from the penalty and interest relief under Track 2 General Program.

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 charged other penalties, as applicable, and will not be eligible for interest relief.

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

Furthermore, in consideration for the relief being provided under the Limited Program, a taxpayer will be required to waive his/her further right to object in relation to the specific matter disclosed in the VDP application and any specifically related assessment of taxes. However, applicants will retain their right to file a Notice of Objection for such things as calculation errors, mischaracterization or issues other than the matter disclosed in the application.

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 will be eligible for relief under the VDP before proceeding with a disclosure.

When a taxpayer makes a “no-names”, the CRA’s no-names opinion confirming eligibility remains binding on CRA for 90 days after issuance. In addition, the taxpayer’s eligibility for relief under the VDP will not be compromised if a CRA audit of the taxpayer is initiated within this 90-day period.

The Proposed Changes 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.

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 Draft Memorandum, 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.)

In order for an application to be considered complete, the Proposed Changes will require that the taxpayer’s application be made for the four years before the date the application is filed for Track 1, for the six years before the date the application is filed for Track 2, and for all relevant years for Track 3.

The Proposed Changes suggest that the “completeness” criteria may also be met 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 revenue amounts related to years for which documentation is unavailable.

Disclosure of advisors

Where a registrant received assistance from an advisor in respect of the subject matter of the application, the Draft Memorandum provides that the name of the advisor should generally 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.

Expanded list of circumstances where relief will not be considered

In addition to creating a three-track system, the Draft Memorandum also provides a new and expanded list of circumstances in which applications under the VDP will not be generally accepted.

Most notably, the Proposed Changes preclude applications where a registrant is attempting to increase the amount of ITCs, other credit adjustments or rebates without a corresponding increase in tax liability.

The Draft Memorandum also makes clear that applications dealing with an election, such as one for nil consideration between closely related persons, will not be considered.

Finally, applications under the VDP will not be accepted from persons that have become bankrupt or are in receivership.

Cancellation of relief for misrepresentation

The Proposed Changes 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.

Conclusions

The Proposed Changes 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.

By limiting a taxpayer's access to the VDP due to the taxpayer's level of sophistication, these so-called sophisticated taxpayers are being unfairly prejudiced. Based on our own experience, large, international organizations, whom the CRA would likely characterize as "sophisticated", can encounter innocent or inadvertent tax non-compliance as result of operational or systemic problems not uncommon to any large organization. By its nature, a large organization generally has multiple operating divisions or branches, which do not always interact seamlessly with each other on their integration. Errors inevitably creep into the system. These organizations are no less worthy of penalty relief than smaller taxpayers seeking to remedy inadvertent tax non-compliance.

Under Tracks 2 and 3, another practical impediment to making a voluntary disclosure is the number of years that the CRA requests be disclosed. The taxpayer will be required to disclose up to six years before the date the application is filed for Track 2, and for all relevant years for Track 3. The normal statutory limitation period within which to assess GST/HST is normally four years. Moreover, by law, the CRA cannot grant penalty or interest relief beyond 10 years before the application is filed, so the CRA would not be precluded from imposing gross negligence penalties under Track 3, to the extent that the disclosure extends beyond this 10-year period. Rather than volunteering statute-barred years, the taxpayer may be better off not coming forward to make a voluntary disclosure. There may, in fact, be an incentive for not completing a voluntary disclosure, in which case the CRA could end up with nothing (i.e., no recovered tax revenues).

The severely curtailed "no-names" disclosure process will also reduce the effectiveness of the VDP. By reverting to the "no-names" consultation process that was in effect before the Current VDP, the CRA will unlikely be able to persuade reluctant taxpayers to proceed with a voluntary disclosure (if the previous experience with this form of "no-names" disclosure process is any reasonable guide).

Overall the Proposed Changes will likely result in a reduced number of voluntary disclosures, and a corresponding decrease in the taxes recovered, under the VDP, undermining the purpose of the VDP.

Taxpayers that are contemplating a potential voluntary disclosure, especially one involving applicants with facts or circumstances in their disclosure that would place them in Track 3 or that would disqualify them from acceptance into the program altogether, 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 under the Draft Memorandum.

Next Steps

The CRA is accepting public comments on the Proposed Changes contained in the Draft Memorandum until August 8, 2017. This consultation 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 Proposed Changes, 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 sometime in 2018.

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[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.