Correcting Past Tax Mistakes

Navigating the Shifting Waters of the Voluntary Disclosure Programs in the United States and Canada

Webinar 1: Individuals and Trusts

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Overview

- Introduction
- Basics of Voluntary Disclosure Programs
    - United States
    - Canada
- Managing a Cross-Border Disclosure
- Questions

Tax Omissions and Deficiencies

Why the Heighted Focus

- Budget Deficits
  - IRS estimates that tax evasion costs U.S. $458 billion per year in tax revenues
  - Estimate of lost tax revenue in Canada is $50 billion per year
- Increased Media Focus on Offshore Activities
  - Panama Papers
- Implementation of intergovernmental information sharing programs
  - Tax Information Exchange Agreements (TIEAs)
  - Foreign Account Tax Compliance Act (FATCA)
  - Common Reporting Standard (CRS)

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Tax Omissions and Deficiencies

Why the Heightened Focus

- How successful are Voluntary Disclosure Programs?
  - In 2016, the IRS announced that almost 100,000 taxpayers had made voluntary disclosures since 2009
  - These voluntary disclosures brought in more than $10 billion in taxes, interest and penalties
  - In a report to Parliament, the CRA stated that, in 2016, 19,134 taxpayers made voluntary disclosures
  - The CRA estimates that these voluntary disclosures reported more than $1.3 billion in income

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Grappling with Cross-Border Tax Issues

Unique Considerations

- Adjusting income in one jurisdiction can have collateral effects in other jurisdictions
- Conflicting domestic legislation can present issues. Each jurisdiction has different:
  - Tax Rates
  - Tax Bases
  - Limitation Periods
  - Types of Taxes
- Tax Treaties and Competent Authority Proceedings
  - Existence of tax treaty can assist with potential cross-border complications

Voluntary Disclosure Programs: A U.S. Primer

History of U.S. Federal Voluntary Disclosure Program

- 2003: IRS launches initial offshore disclosure program
- 2008: UBS scandal
- 2008-2013: DOJ launches investigations of ~14 additional Swiss banks, including Julius Baer and HSBC Private Bank ("Category 1" banks)
- 2010: Congress enacts *Foreign Account Tax Compliance Act* (FATCA)
- August 2013: U.S. and Swiss authorities announce U.S. Program for Swiss Banks
- July 2014: FATCA takes effect
- January 2016: Final Non-Prosecution Agreement is signed under Swiss Bank Program, bringing total number of Banks to 80 and total penalties to $1.36 billion

Voluntary Disclosure Programs: A U.S. Primer

Where Are We Now?

- Offshore tax enforcement is a top priority
- New IRS CI unit dedicated to global tax investigations
- Increased cooperation with foreign governments and international agencies
- Greater volume of information, due to: (i) Swiss Bank Program disclosures; (ii) voluntary disclosures; (iii) disclosures provided as cooperation credit; (iv) information summonses; and (v) DOJ's more sophisticated understanding of offshore tax evasion schemes
- More robust enforcement of tax laws against taxpayers with undisclosed offshore accounts and those who assisted them (*e.g.*, financial institutions, bankers, accountants, attorneys)

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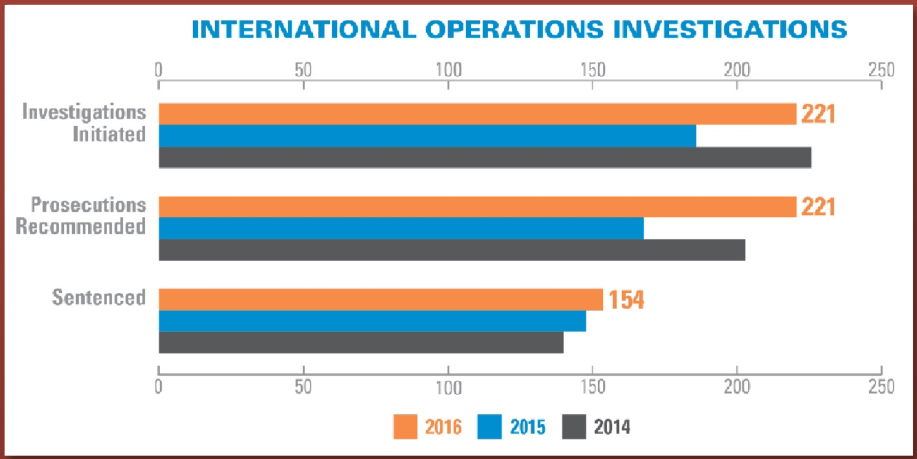
Voluntary Disclosure Programs: A U.S. Primer
Where Are We Now?

- The result:



Source: Internal Revenue Service, Criminal Investigation, 2016 Annual Report at p. 35.

- Potential consequences of enforcement action: incarceration, civil/criminal penalties, deferred prosecution agreements/non-prosecution agreements

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Voluntary Disclosure Programs: A U.S. Primer

Program Parameters

- Offshore v. Domestic Voluntary Disclosure
  - IRS has been focused on offshore tax evasion
  - Taxpayers with offshore and domestic tax issues can disclose both via the offshore voluntary disclosure program
  - Current program was announced in 2012 and is open indefinitely
  - All taxpayers can participate
- What years are included?
  - Most recent 8 years for which the filing deadline has passed

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Voluntary Disclosure Programs: A U.S. Primer

Program Parameters

- What are the penalties?
  - Unpaid tax
  - Interest
  - A penalty of 27.5% of the maximum value of the offshore assets; 50% if the disclosure involves an offshore account and the financial institution has been identified as being under, or cooperating with, a government investigation

Voluntary Disclosure Programs: A U.S. Primer

Program Parameters

- Relief Granted – Why make a voluntary disclosure?
  - Avoid criminal prosecution for failure to report income and pay tax
  - Avoid civil tax penalties that can amount to the entire value of the offshore assets
- Who is not eligible to make a voluntary disclosure?
  - Taxpayers under civil examination for any year, even if it does not involve offshore assets
  - Taxpayers under criminal investigation

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Voluntary Disclosure Programs: A U.S. Primer
Program Parameters

- Streamlined Voluntary Disclosure
    - Only individuals and estates are eligible to participate
    - Taxpayer must certify that the failure to report income and pay tax was non-willful
    - In addition to unpaid tax and interest, U.S. resident taxpayers pay a penalty of 5%. Non-U.S. resident taxpayers are not subject to any penalty.
    - Could still be subject to criminal prosecution if IRS believes failure to pay tax was willful.

Voluntary Disclosure Programs: A U.S. Primer

Steps and Timing

- Filing of Pre-Clearance Request
  - Confirmation that taxpayer is not already subject to IRS Investigation
  - Simple fax to IRS-CI
- Submission of Disclosure Letter and Attachments
  - Provides detailed information about each offshore asset
  - Must be submitted within 45 days after receipt of pre-clearance confirmation
  - Payment must be submitted at this time
- Receipt of Preliminary Acceptance
  - IRS confirms that taxpayer has been accepted into the voluntary disclosure program
  - Taxpayer is obligated to timely reply to all requests from IRS

Voluntary Disclosure Programs: A U.S. Primer

Steps and Timing

- Amendment of Returns
  - Taxpayer should ensure that any other previous errors or omissions are corrected
  - All previously unfiled information returns must be filed, including Foreign Bank Account Reports (FBARs)
- Closing Agreement
  - Upon completion of process, IRS and taxpayer enter into a closing agreement in which taxpayer confirms that all income has been disclosed

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Voluntary Disclosure Programs: A U.S. Primer

State and Local Voluntary Disclosures

- Changes in federal tax liability will affect state and local income tax liability
- Most states have their own voluntary disclosure programs
- Process and lookback periods will vary state to state

The Canadian VDP: History and Recent Trends

- The VDP dates back almost 50 years
  - Available relief under the program has expanded and contracted over time
- In recent years, the VDP has become less flexible
  - Program centralized in two CRA Tax Centres
  - Stricter enforcement of VDP formalities
  - Reduced opportunity for “no-name” discussions
  - Heightened focus on offshore compliance

The Canadian VDP: Scope

- Key statutes that fall within the ambit of the VDP
  - *Income Tax Act*
  - *Excise Tax Act*
  - *Excise Act, 2001*
- Ten year limitation inherent in the *Income Tax Act*
- Many provincial programs are administered by the CRA
  - However, be mindful of the Provinces of Quebec and Alberta

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The Canadian VDP: Relief Currently Offered

- **Penalties**
- **Prosecution**
- **Partial interest relief**
  - In respect of reassessments for years preceding the three most recent years for which returns are required to be filed

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The Canadian VDP: Required Elements

The disclosure must be "voluntary"

- CRA: "A disclosure is considered voluntary if a taxpayer did not initiate the disclosure based on current knowledge of <u>enforcement activities</u>."
  - "Enforcement activities" are defined expansively by the CRA

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The Canadian VDP: Required Elements

The disclosure must be "complete"

- Taxpayers are not permitted to "pick and choose" which deficiencies to disclose
- The CRA expects a taxpayer to have made all inquiries that a reasonable person would have made to confirm full compliance

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The Canadian VDP: Required Elements

The disclosure must involve a "penalty"

- A valid voluntary disclosure must involve the application, or potential application, of a penalty
- Penalties can include discretionary penalties (e.g., gross negligence penalties)

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The Canadian VDP: Required Elements

The disclosed information must be "one year past due"

- A disclosure must include information that is at least one year past due, or information that is less than one year past due where the disclosure is to correct a previously filed return or also includes information that is one year past due

The Canadian VDP: "No-Name" Disclosures

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

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The Canadian VDP: “No-Name” Disclosures

- Identity of the taxpayer making a “no-name” disclosure must be revealed within 90 days of the EDD
- Historically, the “no-name” process facilitated meaningful discussions with the CRA about a potential disclosure
- However, in recent years, increasingly limited commitments/ insights have been made by the CRA at the “no-name” stage

The Canadian VDP: 2018 Reforms

- Announced in June 2017
- Effective January 1, 2018
- Reforms will profoundly restrict the VDP
    - Narrower eligibility criteria
    - Imposition of additional conditions for relief
    - Less generous relief under certain circumstances

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The Canadian VDP: 2018 Reforms

- Two-track eligibility system
  - “General Program”
    - Relief similar to that offered under the current VDP

The Canadian VDP: 2018 Reforms

- "Limited Program"
  - Applications that disclose "major non-compliance"
    - 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 CRA statements/campaigns
    - Any other circumstance involving a high degree of taxpayer culpability
  - Available relief limited – no criminal prosecution or <u>gross</u> negligence penalties
  - Disclosure subject to heightened review
  - Objection/appeal waiver required

The Canadian VDP: 2018 Reforms

- Elimination of “No-Name” Disclosure Program
  - Replaced with “pre-disclosure discussion” process
  - No audit protection prior to the release of the disclosing taxpayer’s identity
- Reduction of available interest relief
  - 50% of the applicable interest for years preceding the three most recent years

Successfully Managing a Cross-Border Voluntary Disclosure: Process, Tips and Traps

1) Advance Planning is Key

Identify and catalogue:

- the universe of deficiencies;
- the potential tax impacts; and
- the implicated taxation years

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Successfully Managing a Cross-Border Voluntary Disclosure: Process, Tips and Traps

1) Advance Planning is Key
   - Confirm that you are able to make a full set of voluntary disclosures
     - Will relief be available in all relevant jurisdictions?
     - Are you willing to disclose <u>all</u> past deficiencies?
     - Can you confidently identify all past deficiencies?
     - Is sufficient documentation available to support your disclosure?
     - Will you be able to pay all tax and interest amounts owing as a consequence of making the voluntary disclosure?

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Successfully Managing a Cross-Border Voluntary Disclosure: Process, Tips and Traps

1) Advance Planning is Key
   - Consider collateral effects
     - Are other withholding obligations affected by the disclosed matters?
     - Do the disclosures have implications for future taxation years?
     - Will other related (or unrelated) parties be impacted by the disclosure?
     - Could the tax disclosure trigger other regulatory inquiries/investigations?

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Successfully Managing a Cross-Border Voluntary Disclosure: Process, Tips and Traps

2) Coordinate Timing and Submission of Disclosures
   - Remain mindful of information exchange agreements and voluntariness requirements
   - Ensure disclosures in different jurisdictions are consistent and compatible

Successfully Managing a Cross-Border Voluntary Disclosure: Process, Tips and Traps

3) Cross-Border Voluntary Disclosure Checklist
   - Advance due diligence
     - Factual matters
     - Contractual matters
     - Procedural matters

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Successfully Managing a Cross-Border Voluntary Disclosure: Process, Tips and Traps

3) Cross-Border Voluntary Disclosure Checklist
   - Filing, Notification and Payment Matters
     - Completion of “no-name” process
     - Notification of affected parties
     - Identity disclosure
     - Completion of factual/legal submissions in each jurisdiction
     - Filing of outstanding returns in each jurisdiction
     - Posting of payments/security
     - Correction of future procedures

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