# Correcting Past Tax Mistakes

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

*Webinar 2: Corporations*

November 2, 2017

mcmillan


***Presented by:***

**Nora Burke**, Partner, Tax, Pillsbury

**Michael Friedman**, Partner, National Tax Group Leader, McMillan

**Anne Lefever**, Counsel, Litigation, Pillsbury


pillsbury

# Overview

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



mcmillan pillsbury

# Tax Omissions and Deficiencies

*Why the Heightened 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)



mcmillan pillsbury

# 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

# 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?*

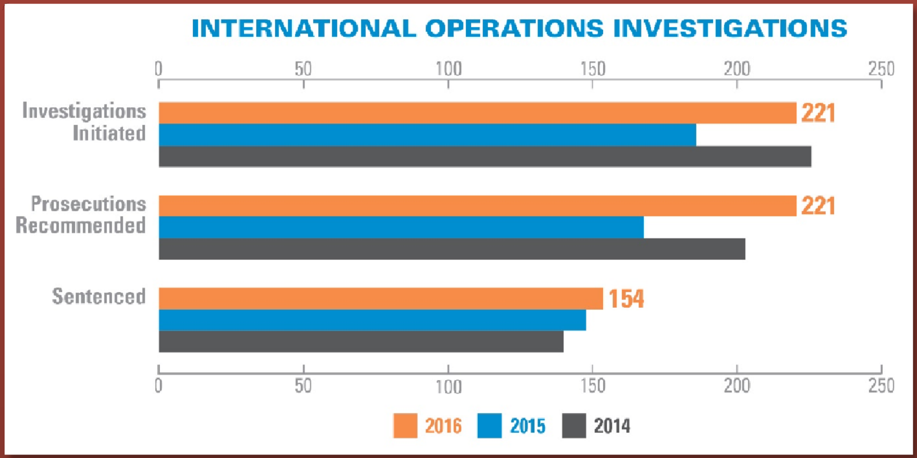
- Offshore tax enforcement is a top priority
- New IRS CI unit dedicated to global tax investigations
- Increased cooperation with foreign governments and international agencies
- Greater volume of information, due to: (i) Swiss Bank Program disclosures; (ii) voluntary disclosures; (iii) disclosures 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)



mcmillan pillsbury

# 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



mcmillan pillsbury

# 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

# 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



mcmillan pillsbury

# 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

# 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

# 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
  - Programs cover not only income taxes, but other state imposed taxes included sales and use tax
  - 38 States and the District of Columbia participate in the multi-state voluntary disclosure program
- 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



mcmillan pillsbury

# 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



mcmillan pillsbury

# 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

# 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 enforcement activities.”
  - “Enforcement activities” are defined expansively by the CRA

# 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
- The CRA also expects reasonable inquiries to have been made regarding the compliance status of all related entities within a corporate group



mcmillan pillsbury

# 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)

# 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

# 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

# The Canadian VDP: 2018 Reforms

- Two-track eligibility system
  - o "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



mcmillan pillsbury

# 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



mcmillan pillsbury

# The Canadian VDP: 2018 Reforms

- Expanded circumstances where no relief offered
  - Corporations with gross revenue exceeding $250 million in at least two of its last five taxation years
  - Transfer pricing adjustments/penalties
  - Certain Competent Authority proceedings

# 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



mcmillan pillsbury

# 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?



mcmillan pillsbury

# 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?



mcmillan pillsbury

# 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



mcmillan pillsbury

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

3) Special Considerations in Advance of a Sale Transaction
   - Transaction due diligence
   - Disclosure to facilitate reps & warranties / closing
     - Timing
     - Audit uncertainty
     - Carriage of disclosure



mcmillan pillsbury

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

4) Public Disclosure Considerations
   - Timing of public notification
   - Jurisdictional considerations




mcmillan pillsbury

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

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




mcmillan pillsbury

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

5) Cross-Border Voluntary Disclosure Checklist
   - Filing, Notification and Payment Matters
     - Completion of “no-name” process
     - Notification of affected parties
     - Identity disclosure and public releases/lender notifications
     - Completion of factual/legal submissions in each jurisdiction
     - Engagement of Competent Authorities, if possible
     - Filing of outstanding returns in each jurisdiction
     - Posting of payments/security
     - Correction of future procedures

# CLE Verification Code

# 2017-094

# Speakers


**Nora Burke**
*Partner, Tax, Pillsbury Winthrop Shaw Pittman LLP,*
*New York, New York*
nora.burke@pillsburylaw.com
Tel: 212.858.1275

**Michael Friedman**
*Partner, National Tax Group Leader, McMillan LLP*
*Toronto, Ontario*
michael.friedman@mcmillan.ca
Tel: 416.865.7914

**Anne Lefever**
*Counsel, Litigation, Pillsbury Winthrop Shaw Pittman LLP*
*New York, New York*
anne.lefever@pillsburylaw.com
Tel: 212.858.1267