Canada to Revise Tax Voluntary Disclosures Program Effective March 1, 2018: New Regime will Result in Limited Relief for Certain Taxpayers Disclosing Errors and Omissions

The Canadian Government released a revised version of Information Circular IC00-1R6, *Voluntary Disclosures Program*, on December 15, 2017 (the "**Circular**") which will apply to voluntary disclosure applications received by the Canada Revenue Agency (the "**CRA**") on or after March 1, 2018.[1]

The Circular describes the program by which the CRA administers the discretionary authority of the Canadian Minister of National Revenue (the "**Minister**") to grant relief from interest and penalties arising from errors and omissions relating to income tax and source deductions.[2]

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1 A draft version of IC00-1R6 was released for comment in June 2017. This commentary will focus on the final version released in December 2017.

2 GST/HST Memorandum 16.5, *Voluntary Disclosures Program* provides information on the Minister's authority to grant relief under the *Excise Tax Act*; the *Excise Act*, 2001; the *Air Travellers Security Charge Act*; and the *Softwood Lumber Products Export Charge Act*, 2006.

For taxpayers considering making a voluntary disclosure in respect of Canadian income tax issues, the changes will generally result in greater uncertainty as to the specific relief of interest and penalties that may be granted.

The changes to the voluntary disclosure program (the "**VDP**" or the "**Program**") include:

- requiring immediate payment of the estimated taxes owing as a condition to qualify for the program;
- removing the "no-name" disclosure method which had provided temporary anonymity to taxpayers who were uncertain about their tax positions;
- introducing a new Limited Program which provides reduced relief to taxpayers in cases where there is an element of intentional conduct in a taxpayer's failure to comply with tax obligations;
- explicitly reserving the right of the CRA to audit or verify information provided in a VDP application and to cancel relief that may have been granted under the VDP as a result of any misrepresentation due to neglect, carelessness, wilful default or fraud; and
- for the Limited Program, requiring that taxpayers waive their rights to object and appeal in relation to the specific matter disclosed and any related assessment of taxes.

Voluntary disclosure applications that are received on or before February 28, 2018 will be processed under the "old" Program. However, while some taxpayers may be tempted to rush to file applications by February 28, 2018 in order to participate in the old Program, consideration should be made as to whether there is sufficient time to do so properly and whether it is advisable to submit an application under the new Program despite the drawbacks of the new regime.

In this regard, it is recommended that taxpayers who have sufficiently completed their analysis of the potential errors and omissions, the information and document gathering, and return preparation, file an application under the old Program, as it will generally result in greater certainty with respect to the tax relief available. Also, having an earlier effective disclosure date (as discussed below) will almost always be beneficial to the taxpayer.

Overview of the New Voluntary Disclosure Program

The purpose of the CRA voluntary disclosure program is to encourage taxpayers to voluntarily come forward and correct errors and omissions in their tax affairs. If accepted into the Program, the taxpayer will generally have to pay the taxes owing as well as full, or partial, arrears interest. Such taxpayers would also typically be eligible for relief from prosecution and certain penalties (see discussion of the General Program and Limited Program below).

In order to be accepted into the new Program, the following five conditions must be met:

- Voluntary: The disclosure must be "voluntary" which means that no "enforcement action" has been initiated with respect to the information being disclosed to the CRA;
- Complete: The disclosure must be "complete" which requires that accurate facts be disclosed for all relevant taxation years or reporting periods. If books and records no longer exist, the taxpayer should make reasonable efforts to estimate the income at issue for those years;
- Penalty: The disclosure must involve the application or potential application of a penalty;

- One Year Past Due: The disclosure must include information that is at least one year past due; and
- Payment: The taxpayer must either include payment of the estimated tax owing with the VDP application or make arrangements for payment with the CRA collections officials. Payment of the estimated tax was not a condition of acceptance in the old Program.

Making a disclosure application requires that the taxpayer or its tax advisor: (i) provide the requisite information in Form RC199, either on the form itself or other correspondence, (ii) file all relevant tax returns, forms and schedules (including amended returns) necessary to correct any non-compliance, (iii) name the advisor that assisted in the VDP application, and (iv) co-operate with any requests by the CRA for books, records or other documents.

The effective date of disclosure is the date the CRA receives a completed and signed disclosure application. The taxpayer has up to 90 days (subject to an extension if available) from this date to complete the application. The taxpayer is also granted protection from the initiation of prosecution action related to the disclosure from this effective date.

The Circular explicitly states that a second application will be denied where it is made for the same issue that was previously denied for being incomplete due to outstanding information not being received by the required date.

Removal of No-Name Voluntary Disclosure Method

Under the old Program, there was an option for the taxpayer to proceed under a “no-name” voluntary disclosure method. This “no-name” method typically required that the taxpayer reveal the taxpayer’s identity within 90 days of the effective date of disclosure. If the taxpayer decided not to proceed, a subsequent opportunity to make a “no-name” disclosure would not be available and there would also be the risk of an enforcement action based on the incomplete details provided.

While the “no-name” method often provided comfort to clients, the requirement to reveal the taxpayer’s identity in 90 days often resulted in the taxpayer having to decide whether to proceed based on limited information. In practice, a taxpayer making a voluntary disclosure on a “no-name” basis would have been prepared to proceed with the disclosure application barring unforeseen circumstances. Nonetheless, the removal of the “no-name” method could create further uncertainty and discourage taxpayers from making voluntary disclosures.

The Circular does refer to the availability of preliminary discussions with the CRA prior to making a disclosure application. However, it is uncertain, at this early stage of the Program, how this differs from the general assistance that the CRA currently provides, such as by way of an informal request to CRA rulings directorate.

General Program vs Limited Program

A major change in the new Program is that income tax disclosures will now fall into two different tracks: (i) a General Program which provides penalty relief and partial interest relief, and (ii) a Limited Program with reduced relief.

Under the General Program, in addition to not charging penalties, the Minister will typically grant partial relief in the application of arrears interest. Under the new Program, this partial interest relief is 50% of the applicable

interest in respect of assessments for years preceding the three most recent years of returns required to be filed. Under the old Program, the partial interest relief was typically a reduction of the arrears interest rate by 4%. As before, full interest will be charged for the three most recent years of returns required to be filed under the new Program.

Under the Limited Program, the taxpayer will not be charged gross negligence penalties nor referred for criminal prosecution. However, the taxpayer will be responsible for paying tax, full interest and other applicable penalties.

The *Income Tax Act* (Canada) limits the Minister's ability to grant penalty and interest relief only to taxation years that ended within the previous ten (10) years before the calendar year in which the application is filed. However, the Minister can grant relief on the interest that accrued during the previous ten (10) calendar years regardless of the taxation year (or fiscal period) in which the tax debt arose.[3]

The CRA will notify the taxpayer, on acceptance into the Program, whether the disclosure has been accepted into the General Program or the Limited Program. The Circular states that VDP applications that disclose non-compliance involving an element of intentional conduct on the part of the taxpayer, or a closely related party, will fall in the Limited Program.

The Circular lists the following factors that the CRA may consider in accepting a disclosure into the Limited Program:

- efforts were made to avoid detection through the use of offshore vehicles or other means;
- the dollar amounts involved;
- the number of years of non-compliance;
- the sophistication of the taxpayer; and
- the disclosure is made after an official CRA statement or broad-based CRA correspondence regarding a specific compliance focus of the CRA.

Furthermore, the Circular states that, generally, applications by corporations with gross revenue in excess of $250 million in at least two of the last five taxation years, and any related entities, will only be considered under the Limited Program.

Disputing the Results of the Voluntary Disclosure Program Application

As the Program is an exercise of the discretionary authority of the Minister, a taxpayer who disagrees with the Minister's decision in respect of the relief provided would, in the first instance, request a second level administrative review on the basis that the Minister has not exercised its discretion in a fair and reasonable manner. The taxpayer can also make an application to the Federal Court for a judicial review of the decision although, in most cases, a second level administrative review should be requested first.

Under the old Program, the taxpayer still had the right to file a notice of objection to an assessment or reassessment resulting from the VDP application with which the taxpayer disagrees. However, under the new

[3] See *Bozzer*, [2011] 5 C.T.C. 1 (FCA).

Program, a taxpayer that is accepted under the Limited Program will be required to waive their rights to object and appeal in relation to the specific matter disclosed and the specific assessment of taxes (other than with respect to a calculation error or a characterization issue).

Practical Concerns with the New Program

In making a voluntary disclosure application, it is important to not only identify that one or more errors or omissions have been made, but to ensure that all the errors and omissions have been identified. Accordingly, it is important to have tax advisors with broad experience that can identify all the related issues, properly characterize the transaction, provide a plan to remedy the errors or omissions, and file an application that is “voluntary” and “complete”.

Once an application has been made, the time to provide complete information is short. Gathering information and documents, especially if the location of the records is overseas, can be time-consuming. Accordingly, sufficient time should be allowed to not only gather the information, but also to prepare the new returns and amended returns that may have to be filed. Additional issues can arise which will require further consideration and, in such cases, advisors with broad experience can be helpful.

The possibility of being accepted into the Limited Program and, in many cases, not knowing if the application will be accepted into the Limited Program for certain taxpayers until after most of the disclosure has been made, is a disincentive for taxpayers to participate in the program. Not only does the Limited Program provide reduced relief, it also requires the taxpayer to waive certain rights to file a notice of objection.

This uncertainty can be mitigated by weighing the likelihood that a particular taxpayer that is disclosing a particular issue will be accepted into the Limited Program. Given the factors listed in the Circular, this will require some experience as to what the CRA may consider a “sophisticated taxpayer”, a material dollar amount of tax owing, or the types of issues that the CRA has made a specific focus area of compliance.

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