Don't Delay; Disclose Today: Substantial Changes to the Voluntary Disclosure Program Take Effect March 1, 2018

January 11, 2018

On December 15, 2017, the Canada Revenue Agency ("CRA") released two highly-anticipated policy statements outlining several changes to its Voluntary Disclosures Program (the "VDP"). By and large, the changes narrow the application of the program, limit — and in some cases, eliminate — relief available in various circumstances, and introduce more onerous criteria for access to the program.

Key changes to the VDP include:

- The introduction of a two-track program for income tax disclosures and a three-track program for GST/HST disclosures;
- A general requirement that estimated taxes be paid when a disclosure is made;
- An expansion of the circumstances in which a voluntary disclosure will not be considered or will be considered only with limited benefits; and
- The elimination of the "no-names" disclosure program.

These changes, which apply to disclosures relating to income tax, GST/HST and other taxes, will come into effect on March 1, 2018. Applications received by the CRA before February 28, 2018 will be processed under the current VDP only if the name of the disclosing taxpayer is provided by that date. Given the significantly reduced relief and the increased uncertainties created by the new VDP, non-compliant taxpayers are encouraged to act quickly to benefit from the existing program.

The Current VDP

The VDP is a form of amnesty program which allows taxpayers to voluntarily come forward to correct omissions or errors in their prior tax reporting in exchange for immunity from prosecution and relief from penalties and potentially some interest. Since its inception, the program has generated significant interest. In the 2014-2015 year alone, more than 19,000 voluntary disclosure applications were made, and more than $1.3 billion of previously unreported income was disclosed.[1]

In its current form, the VDP is generally available to all taxpayers regardless of the reason for their non-compliance, so long as the following four conditions are met:

- the disclosure is voluntary — that is, the disclosing taxpayer must initiate the disclosure process before becoming aware of an enforcement action which would (or would be likely to) reveal the error or omission to CRA;
- the disclosure involves the application (or potential application) of a penalty;
- the disclosure includes information that is at least one year past due; and
- the disclosure is complete, in that it provides full and accurate facts for all taxation years or reporting periods for which there was tax non-compliance, across all of the accounts associated with the disclosing taxpayer.

Under the current VDP, a disclosure can be initiated on a "named" basis, by which the name of the disclosing taxpayer is provided at the time the application is commenced, or on a "no-name" basis, by which only general information is provided to the CRA about the non-compliance at the time the disclosure is commenced. If the taxpayer wishes to proceed with implementation of a no-name disclosure, the taxpayer is required to reveal their identity to the CRA within 90 days. In either case, disclosing taxpayers generally receive immunity from prosecution and penalties (and possibly relief from some interest) from the effective date of the disclosure.

The New VDP

On June 9, 2017, as part of the CRA's increased efforts to crack down on aggressive tax avoidance and evasion, the CRA released proposed changes to the VDP. The proposals would have drastically curtailed the relief available to many non-compliant taxpayers. Reaction from tax professionals and the public was negative. The proposed changes were heavily criticized as vague, imprecise and harsh, potentially discouraging many non-compliant taxpayers from coming forward at all.

Following consultations with stakeholders, the CRA released *Information Circular 1C00-1R6* and *GST/HST Memorandum 16-5*, establishing the framework for the VDP effective March 1, 2018.

Two (or Three) Tracks for Voluntary Disclosures

For income tax disclosures, IC00-1R6 preserves the concept of a "two-track" system proposed in June 2017. Under the new VDP, income tax disclosures will be streamed into either the "Limited Program" or the "General Program".

For disclosures involving GST/HST or other taxes, the Memorandum introduces three tracks: "Category 1", which deals with disclosures involving certain eligible so-called wash transactions; "Category 2", which deals with certain non-eligible wash transactions, reasonable errors, failures to file information returns or over-claimed rebates; and "Category 3", which provides limited relief in respect of applications that disclose non-compliance with an element of intentional conduct on the part of the registrant or a closely related party.

The following highlights some of the key features of each program track:

Category 1 (GST/HST)

- Provides relief for applications that involve "wash transactions"[2] that are eligible for a reduction of penalties and interest under the Memorandum.
- Entitles applicants to relief from all otherwise applicable penalties and 100 per cent of the applicable interest.
- According to the Memorandum, the CRA will consider granting penalty and interest relief in wash transactions where the following conditions are met:
    - the taxable supply in question was made to a registrant who would have been entitled to a full input tax credit ("ITC") had the tax been applied correctly, or to a federal department or participating provincial government entity;
    - in cases where the ITC was claimed by the wrong member of a closely related group or by an associated person, it must be demonstrated that the person who was actually entitled to claim the ITC is a registrant that would have been entitled to a full ITC;
    - the person being assessed must have a history of voluntary compliance with their GST/HST obligations, and must not have been previously assessed for the same mistake;
    - the person being assessed must have implemented corrective measures to ensure that tax is properly collected and ITCs properly claimed on future supplies of a similar nature; and
    - the person being assessed must not have been negligent or careless in carrying out its GST/HST obligations.

General Program/Category 2

- Any disclosure that is not a Limited Program disclosure or a Category 1 (GST/HST) disclosure will be subject to the General Program.
- Provides immunity from prosecution, relief from applicable penalties and possibly some interest relief.
- Unlike the proposed changes released in June 2017, IC00-1R6 does not specifically preclude "sophisticated taxpayers" from accessing relief under the General Program for income tax disclosures.

Limited Program/Category 3

- Provides limited relief for VDP applications where the taxpayer's non-compliance involves what CRA describes as "an element of intentional conduct" on the part of the disclosing taxpayer or a closely related party.
- Relief limited to immunity from prosecution and relief from gross negligence penalties (but no relief from otherwise applicable penalties or interest);
- Disclosing taxpayers must agree to waive their rights of objection and appeal relating to the substance of the disclosure and any related tax assessment.
- Whether a disclosure will be a Limited Program disclosure will depend on some or all of the following factors:
    - whether the taxpayer made efforts to avoid detection through offshore vehicles, the underground economy or other means;
    - the dollar amounts involved;
    - the number of years of non-compliance;
    - the sophistication of the taxpayer; and/or

- whether the disclosure was made after an official statement from the CRA regarding an intended specific focus of compliance (*i.e.*a publicly-announced program in relation to a particular compliance issue).

Elimination of No-name Disclosures

The new VDP will no longer allow taxpayers to make a disclosure (in respect of either income tax, GST/HST or other taxes) on a no-name basis. However, taxpayers may engage in "pre-disclosure discussions" with the CRA to test the facts of their situation and assess the likely outcomes of a disclosure. It is important to note, however, that although these discussions can be undertaken anonymously and may help to provide some comfort, the discussions are non-binding and do not constitute an acceptance of the taxpayer's disclosure.

"Voluntariness" of a Disclosure

Under the new VDP, a disclosing taxpayer will not be eligible for consideration under the VDP if the CRA has already received information regarding that taxpayer's potential involvement in non-compliance. This is a change from the existing program, which requires only that a taxpayer not be aware of any enforcement action against them.

This change may lead to harsh results, as in many cases it will be impossible for a taxpayer to know what information the CRA has with respect to their affairs before commencing the disclosure.

Interestingly, however, the CRA has indicated that a taxpayer could be eligible to make a voluntary disclosure if the CRA "invites" them to do so, subject to the caveat that a disclosure invited by the CRA would likely be considered only under the Limited Program.

No Automatic Exclusion for Large Corporations

Under the new VDP, disclosures by large corporations will be eligible for consideration, though generally only under the VDP's Limited Program for income tax purposes and under Category 3 for GST/HST and other tax disclosures. This is a significant change from the draft VDP guidelines issued in June, which completely disqualified large corporations having gross revenues in excess of $250 million in at least two of the last five taxation years, from accessing the VDP program for disclosures involving income tax.

Disclosures Involving Transfer Pricing

Although the draft VDP guidelines issued in June 2017 proposed to do away with relief under the VDP for disclosures relating to transfer pricing issues, the new VDP indicates that the CRA may consider applications relating to transfer pricing adjustments. These disclosures will now be handled by the Transfer Pricing Review Committee of the CRA. Note that applications relating to advance pricing arrangements will not be considered for VDP relief.

Mandatory Payment of Estimated Tax

Although the new VDP has added a fifth condition of a valid disclosure application, namely, that the disclosure application must include payment of the estimated tax owing, the CRA is allowing taxpayers to request to be considered for a payment arrangement, perhaps with adequate security. This is an improvement over the June 2017 proposals, by which CRA would only have considered a payment arrangement "in extraordinary circumstances".

Discussion

Information Circular IC00-1R6 and *GST/HST Memorandum 16-5* reflect a significant narrowing of the benefits and advantages of a voluntary disclosure, and a broadening of the conditions that must be met for a valid voluntary disclosure. Under the new regime, disclosing taxpayers will have less certainty and be much less able to predict in advance the benefits of a disclosure. It is quite possible that the changes to the VDP will discourage many taxpayers from accessing the program.

There is still time for taxpayers to correct their mistakes and benefit from the current, more permissive VDP regime. If you are considering making an application under the VDP, do not delay and ensure your application is complete (including the identity of the disclosing taxpayer) and is filed with the CRA before March 2018.

Should you require advice about your specific situation, please contact a leader of the Tax Litigation and Dispute Resolution Group: Salvatore Mirandola |Laurie Goldbach.

[1]Canada Revenue Agency,"Annual Report to Parliament, 2014-2015,"p. 59.

[2]In general terms, a wash transaction occurs where a supplier fails to remit an amount of net tax on a taxable supply (other than a zero-rated supply) as a result of failing to correctly charge and collect tax from the recipient, and the recipient is a registrant who would have been entitled to claim a full ITC in respect of the tax, if the tax had been correctly applied and collected by the supplier.

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