2016

Offshore Compliance Advisory Committee

REPORT ON THE VOLUNTARY DISCLOSURES PROGRAM

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Introduction

The Offshore Compliance Advisory Committee was established by the Honourable Diane Lebouthillier, Minister of National Revenue, in April 2016, with a mandate to provide advice to the Minister and to the Canada Revenue Agency (CRA) on administrative strategies to deal with offshore compliance.

This first report provides background and the Committee's recommendations in respect of the Voluntary Disclosures Program (VDP).

Background

Like tax administrations in most Organisation for Economic Co-operation and Development (OECD) member countries, the CRA offers a VDP under which non-compliant taxpayers who meet conditions for acceptance into the program may come forward and correct their tax affairs. In its most recent report on VDPs, the OECD strongly endorses them as part of a balanced overall strategy for offshore compliance and enforcement:

> Voluntary disclosure programmes complement the rapid improvement in exchange of information and the ability of governments to detect offshore evasion. They are an integral part of a broader compliance strategy – they need to be considered as part of a variety of compliance actions that tax administrations and governments take in order to encourage all taxpayers to meet their obligations.[1]

The OECD report recommends that a VDP be designed (1) to make participating taxpayers pay more than they would pay if they had been fully compliant and (2) to sanction participating taxpayers less severely than it does non-compliant taxpayers. Thus, the VDP should strike a balance that makes it attractive for non-compliant taxpayers to come forward, report income, and comply with the tax laws in the future, while ensuring that law-abiding and conscientious taxpayers will feel that they are treated fairly and will continue to respect the tax system.

[1] OECD, Update on Voluntary Disclosure Programmes: A pathway to tax compliance. OECD, 2015 ("OECD Update")

As stated by the CRA in its *Information Circular* 00-1R4, "Voluntary Disclosures Program," the VDP is intended to promote compliance with Canada's tax laws by encouraging taxpayers to voluntarily come forward and correct previous omissions in their dealings with the CRA; it is not intended to serve as a vehicle for intentional avoidance of legal obligations.

The core mandate of the CRA is to collect revenue in accordance with the tax laws in order to fund government programs and to benefit all Canadians. The Committee believes that, in addition to assisting taxpayers in bringing their tax affairs into order, a well-designed VDP can play a role in this revenue-raising mandate and that it should do so at a moderate administrative cost. Further, a VDP should facilitate disclosure of income that might otherwise be difficult for a tax administration to detect. As noted above, it is critical that compliant taxpayers view the program as fair and balanced and that the CRA has the resources to identify—and to assess tax and penalties on—those who are non-compliant.

Striking a balance between fairness, on one hand, and revenue generation, on the other hand, is critical to the successful operation of a VDP. To appear fair, a VDP should operate under consistent and transparent rules and practices across the country. For example, it should not be so lenient as to raise fairness concerns for taxpayers who are complying with their tax obligations. In this regard, we have been asked to consider the balance between the rewards for full compliance, the consequences of participating in the VDP, and the consequences of serious non-compliance.

The Canadian VDP

The VDP allows taxpayers to disclose previous omissions or errors in their dealings with the CRA. Statutory authority for the exercise of discretion by the Minister in administering the VDP is found in subsection 220(3.1) of the *Income Tax Act* (the "Act").[2] If the taxpayer's disclosure satisfies the conditions set out in IC00-1R4,[3] criminal prosecution and civil penalties under the the "Act" are generally waived, and partial relief for accrued interest on unpaid tax is typically given. All evaded tax must be paid.

[2] Although subsection. 220(3.1) was enacted in 1991, the VDP, in various forms, existed prior to that time without specific statutory basis.
[3] Dated March 14, 2014, paras. 31-42

Relief extended under the VDP to an eligible taxpayer is the same, regardless of the type or scale of the taxpayer's non-compliance. For example, the same relief will be extended whether the failure to comply results from a simple oversight, from a misunderstanding of the law, from deliberate actions to evade taxation, or from a high level of negligence. No distinction is made on the basis either of the amounts in issue or of whether the non-compliance is domestic or offshore.

In considering the VDP, the Committee has focused on getting the right balance between effectiveness in raising revenue, and fairness. The Committee recognizes that fairness is, in its own right, a fundamental principle of any tax system, and we note that in the long run, taxpayers are less willing to participate in and comply with a tax system that is perceived to be unfair or biased in favour of particular taxpayers or groups of taxpayers. A perception of unfairness or bias will almost certainly have a negative effect on revenue collection. The Committee's recommendations are designed to enhance and improve a program that, on the whole, works to the benefit of Canadians.

In forming the recommendations set out below, the Committee

- met with officials involved in the administration of the VDP;
- reviewed and assessed the key elements of the VDP, as described in the CRA's IC 00-1R4;
- compared key elements of the CRA's VDP with those of Revenu Québec's VDP, as outlined in Interpretation ADM.4/R6;
- reviewed and discussed the report in the OECD Update on the design and operation of VDPs in other countries; and
- reviewed and discussed the academic literature[4] on the design and operation of VDPs, a literature that is limited in quantity.

The Committee endorses the continuation of the VDP as an integral part of the CRA's administrative and enforcement regime for identifying and deterring offshore non-compliance. We believe, however, that it could be made more effective and more fair.

[4] An explicit economic model of a VDP is found in Langenmayr, D., "Voluntary Disclosure of Evaded Taxes—Increasing Revenues, or Increasing Incentives to Evade?" CESIFO Working Paper No. 5349, May 2015. The paper briefly reviews other studies in the economic literature relating to VDPs.

Recommendations

1. Less Generous VDP Relief in Certain Circumstances

For any voluntary disclosure, the VDP provides substantially the same relief and operates with the same conditions and requirements. Depending on the particular facts, relief of penalties and partial interest relief could be seen as overly generous.

It is our view that the CRA should view all of the circumstances surrounding the disclosure and that relief from interest and penalties should be reduced in certain cases. For example, where sophisticated taxpayers have sought expert advice and used complex offshore structures to evade significant amounts of tax over several years, the amount of relief from interest and penalties should be reduced. We also question whether taxpayers that have made a completely voluntary disclosure should be treated the same as taxpayers whose disclosure is prompted by the CRA's audit activity, by broad-based CRA compliance programs, or by the CRA's receipt of previously confidential information owing to leaked data. The following is a partial list of circumstances that, in the Committee's view, should cause a taxpayer's relief from interest and penalties to be reduced:

i. deliberate or wilful default or carelessness amounting to gross negligence,
ii. active efforts to avoid detection through the use of offshore vehicles or other means,
iii. large dollar amounts of tax avoided,
iv. multiple years of non-compliance,
v. repeated use of the VDP by a taxpayer who meets clarified requirements for repeated use (see item 2 below),
vi. sophisticated taxpayer,
vii. taxpayer's disclosure motivated by CRA statements regarding its intended focus of compliance or by broad-based CRA correspondence or campaigns,[5]
viii. avoidance transactions undertaken or continued after implementation of the Common Reporting Standard, or

[5] Where the taxpayer does not respond to such a CRA initiative, the CRA should pursue robust enforcement action and should consider discussing such initiatives in the IC.

ix. any other circumstance in which a high degree of taxpayer culpability contributes to the failure to comply.

Relief could be reduced by increasing the period for which full interest must be paid or by denying relief from civil penalties.

2. Repeat Users

IC 00-1R4 states that a taxpayer normally cannot access relief granted under the VDP if the taxpayer has previously made a voluntary disclosure. The Committee endorses this position (which is also contained in the Quebec VDP), but it recommends that the relevant section of the IC be reviewed and given greater prominence. The revised section should clearly connect this position to the more general commitment to fairness under the VDP. This will strengthen confidence among taxpayers generally and contribute to voluntary compliance. The CRA should also ensure that a taxpayer's past participation in the VDP is verified.

3. Payment of Tax and Interest

A taxpayer who has made a voluntary disclosure should be required to pay the estimated tax and interest payable as a result of the disclosure or to provide adequate security within the time frame described in paragraph 53 of IC 00-1R4. Exceptions may be made for extraordinary circumstances, for inability to pay, or for financial hardship, as described in paragraphs 25 and 27 of Information Circular 07-1, "Taxpayer Relief Provisions." The Committee believes that, although the CRA has generally not encountered difficulty in collecting amounts owing as a result of VDP disclosures, this recommendation will strengthen public confidence in the fairness of the tax system.

4. Incomplete Information

In some circumstances, a taxpayer making a voluntary disclosure may be unable, for legitimate reasons, to provide the CRA with full and complete information about the subject matter of the disclosure. Such a taxpayer might, for example, have inherited a non-compliant situation (such as an undisclosed offshore account) from a deceased relative who did not maintain proper records. We understand that, in such a case, the CRA will make a reasonable accommodation for an otherwise good-faith disclosure. We recommend that IC 00-1R4 be reviewed and, if necessary,

revised, so that this accommodation is clear enough to remove the concerns of a taxpayer who is in this situation. We believe that this measure will encourage disclosures involving incomplete information, particularly with respect to offshore non-compliance.

Where no legitimate reasons exist for a taxpayer's failure to provide full and complete information, the CRA should insist on receiving the necessary and relevant information, using its power, where appropriate, to compel taxpayers to provide or develop the information. Taxpayers who are unwilling to do so should be denied the full benefits of the VDP.

5. Transfer-Pricing Penalties

Given the overall purpose and objectives of the VDP, it should not be available for multinational enterprises seeking relief in respect of related-party transfer-pricing issues, including transfer-pricing penalties under subsection 247(3).

6. Disclosure of Advisers

The CRA has confirmed that there exists no requirement to disclose the identity of advisers who assisted with non-compliance (by, for example, helping taxpayers set up offshore accounts or structures). Such disclosures provide valuable information that could materially assist the CRA in identifying advisers that promote and enable offshore non-compliance. These advisers may be liable to third-party penalties or may be guilty of the offence of conspiring to enable tax evasion.[6] The Committee believes that any person making a voluntary disclosure should be required to provide this information.

7. Level of Internal Approval

The CRA has confirmed that internal approval of a VDP settlement occurs at the team-leader level and that this is the case for all VDP files. Consideration should be given to introducing higher-level sign-off requirements in cases involving substantial amounts of evaded taxes, complex arrangements, or new issues of law. The CRA may also want to consider higher-level

[6] Section 163.2 of the Act provides for penalties to be assessed if a third party enables a taxpayer to make false statements for the purposes of complying with the Act. Section 239 of the Act provides that it is a criminal offence to conspire with a taxpayer to enable tax evasion.

approval in high-profile cases that have the potential to undermine public confidence in the program.

8. Review by Specialists

The CRA has advised that VDP procedures emphasize timeliness and efficiency. It is not clear that complex VDP files are, in all cases, being thoroughly examined by CRA personnel with expert knowledge. Consideration should be given to introducing procedures to ensure that large or complex cases are reviewed by specialists before acceptance into the VDP. For example, large or complex cases should be reviewed by offshore compliance specialists, and aggressive tax-planning cases, such as mass-marketed offshore structures, should be reviewed by specialists in aggressive tax planning.

9. Rights of Objection

Under the VDP, taxpayers retain all of their rights to object to an assessment or reassessment of their taxes for a taxation year that was subject to a voluntary disclosure. The CRA advises that objections to reassessments resulting from a voluntary disclosure are quite rare. Taxpayers should not be allowed to object to voluntary disclosure agreements, once these agreements are made. However, taxpayers should not have to give up their rights to object to other issues in their tax returns or to contest whether any adjustments arising from the voluntary disclosure have been properly made.

10. Information Returns

Taxpayers who own certain assets held offshore above a threshold amount must file form T1135. The CRA requires taxpayers that have not filed or have not properly filed a T1135 form to use the VDP, even in circumstances where the taxpayer has reported and paid the appropriate tax on the income being disclosed on the form. The Committee has questioned whether dealing with the volume of VDP applications related solely to unfiled information returns[7] is an appropriate use of CRA resources. The CRA has advised that T1135 VDP applications do not raise material concerns from a resourcing perspective.

[7] That is, where the disclosure does not also include a disclosure of unreported income.

However, the Committee understands that forcing an otherwise compliant taxpayer to access the VDP in respect of unfiled information returns may be unduly burdensome and could encourage continued non-compliance with respect to filing the T1135 form.

The Committee believes that a better approach would be for the CRA to use its audit resources to examine the returns of the taxpayers who fail to file the T1135, in order to verify their compliance. Compliant taxpayers would be given relief for failure to file, while non-compliant taxpayers would be subject to the appropriate reassessment of taxes and penalties.

The Committee understands that this may require the CRA to amend its "fairness package" rules.[8]

11. Different Relief under the VDP for Offshore Non-Compliance

The Committee discussed whether, under the VDP, the penalties for offshore non-compliance should be harsher than those for domestic non-compliance. Other than the possibly less generous treatment of offshore non-compliance proposed in recommendation 1, the Committee concluded that offshore and onshore (domestic) non-compliance should be treated similarly. If the circumstances are similar (with respect to the amount of tax evaded, the active efforts made by the taxpayer to avoid detection, the sophistication of the taxpayer and advisers), offshore non-compliance is no more objectionable than onshore domestic non-compliance. Both forms of non-compliance deprive the government of tax revenues that benefit all Canadians, and both are equally unfair to taxpayers that fulfill their tax-filing and payment obligations.

Offshore Compliance Advisory Committee

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[8] The fairness rules are part of the CRA administrative policy that is used to apply subsection 220(3.1) of the Act.

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