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Tax Alert – Canada

Changes to income tax VDP revised

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 15 December 2017, the Canada Revenue Agency (CRA) released information circular IC00-1R6 - Voluntary Disclosures Program (the new circular), which implements significant changes to the Voluntary Disclosures Program (VDP) that narrow its application and offer less-generous relief, or in some cases no relief, to non-compliant taxpayers. The new circular closely follows the draft circular released on 9 June 2017 and follows an extensive review of the VDP recommendations made in 2016 by both the House of Commons Standing Committee on Finance and the Offshore Compliance Advisory Committee.

Overview

The new circular applies to VDP applications received on or after 1 March 2018. Applications received prior to 1 March 2018 will be processed under the rules set out in information circular IC00-1R5, dated January 2017 (the current circular). For no-name applications, the taxpayer must be named before 1 March 2018 for the current circular to apply, as discussed in more detail below.

Building a better working world

The proposed changes include the following major changes to the CRA's VDP policy for income tax and source deductions:

- Introduction of a "Limited Program": Certain applicants will only be eligible for limited VDP relief, meaning that if the voluntary disclosure is accepted, the applicant will not be assessed gross negligence penalties or referred for criminal prosecution for tax offences, but will not be eligible for relief from interest or late filing penalties, even if their application meets the criteria for VDP eligibility
- Reduction of interest relief
- Reduction of objection rights under the Limited Program
- Applications relating to transfer pricing matters will no longer be handled by the VDP group at the CRA
- Elimination of "no-name" disclosures
- Immediate payment required
- Disclosure of advisor

Issues

EY's previous Tax Alert 2017 No. 26 dated 21 June 2017 provides detailed information on the version of the new circular released on 9 June 2017. The purpose of this current Tax Alert is to help practitioners understand what has changed on a practical basis between the current VDP rules and those coming into effect 1 March 2018. Refer to separate Tax Alert 2017 No. 54 for a discussion of the impact of the new circular on GST/HST disclosures.

Large corporations: For corporations that had "gross revenue in excess of $250 million in at least two of their last five taxation years" or any of their related entities, VDP relief will "generally" only be available under the Limited Program.

It is not clear from the text of the new circular whether the $250 million figure relates to the gross revenue of a single corporation (and consequently affects the characterization of that corporation as well as its "related entities") or whether the $250 million figure is calculated based on the aggregate gross revenue of the corporation *and* its "related entities." The current circular does not differentiate between taxpayers based on income.

"Sophisticated" taxpayers: Apart from large corporations, the new circular indicates that the Limited Program applies to "applications that disclose non-compliance where there is an element of intentional conduct on the part of the taxpayer or a closely related party." In making this determination, the new circular lists the following factors for consideration: "efforts were made to avoid detection through the use of offshore vehicles or other means"; if the disclosure follows "an official CRA statement regarding its intended specific focus of compliance" (e.g., an audit target); "the dollar amounts involved"; "the number of years of non-compliance"; or "the sophistication of the taxpayer."

The current circular does not distinguish between taxpayers who knowingly participated in a tax-avoidance scheme and taxpayers who misreported their tax liability either unwittingly or due to bad advice. Therefore, the window for a knowing tax avoider to obtain relief from interest or late-filing penalties may be closed as of 1 March 2018; however, the new circular does note that "a sophisticated taxpayer may still correct a reasonable error under the General Program."

One immediate impact of the Limited Program, where it is applicable, is that in the case of unfiled information returns, there will generally be no relief for late-filing penalties.

Reduction of interest relief: Under the new circular, disclosures under the Limited Program get no interest relief, whereas disclosures under the General Program may get relief of 50% of the interest for the years prior to the three most recent years of the disclosure. The current circular does not place a 50% limit on interest relief.

Reduction of objection rights: Currently, a taxpayer cannot object to the assessment of penalties or interest made under subsection 220(3.1) of the *Income Tax Act* (the Act) (the taxpayer relief provision related to interest and penalties), and this limitation will continue to apply to VDP applications accepted under either the Limited Program or General Program. However, the new circular further provides that for VDP applications accepted under the Limited Program, the applicant must waive objection and appeal rights with respect to "the specific matter disclosed in the VDP application and any specifically related assessment of taxes." In addition, the new circular notes that the waiver will not apply to calculation errors, characterization issues (e.g., income versus capital treatment) or issues other than the disclosed matter.

Although it is unclear how the mandatory waiver of objection rights will work in practice, it may mean that if, upon the review of an application accepted under the Limited Program, the CRA determines that the taxpayer's income was greater than what was disclosed, the taxpayer may be unable to dispute this determination.

Transfer pricing matters: The CRA's VDP group will no longer handle applications involving transfer pricing issues. Instead, relief requests should be sent directly to the Transfer Pricing Review Committee (TPRC). Although this change is explained by the new circular as being "for efficiency," it is not clear how the TPRC will handle voluntary disclosures, or what relief will be available, especially as transfer pricing issues largely affect large corporations and sophisticated taxpayers.

The current circular excludes applications dealing with advance pricing arrangements (APAs), and this exclusion was continued into the new circular.

Competent authority matters: The new circular specifically excludes "applications that depend on an agreement being made at the discretion of the Canadian competent authority under a provision of a tax treaty."

Elimination of "no-name" disclosures: With what is an important change to the utility of the VDP for practitioners, the new circular completely eliminates the "no-name" disclosure method, meaning that would-be applicants must disclose their identity and file a complete disclosure in order to enter the VDP, whether General or Limited, without a 90-day protective

period to prepare the file without the risk of the losing the disclosure due to an enforcement action.

Instead, would-be applicants can request a "pre-disclosure discussion" with a CRA official in order to, *inter alia*, "get insight into the VDP process" in an "informal, non-binding" manner that does not provide protection to the taxpayer.

The consequence of this change is significant — as of 1 March 2018, practitioners can no longer meet with a client and immediately file a "no-name" disclosure giving the client 90 days of protection in order to prepare a detailed application.

As noted above, in order for the current circular to apply, "the CRA must have received the taxpayer's application, including their name, on or before February 28, 2018." This means that if a "no-name" application was filed prior to 28 February 2018, if the applicant's name is disclosed after 28 February 2018 (i.e., the 90-day period protective period otherwise expires on or after 1 March 2018), the application will be governed by the new circular and not the current circular, even though the application was originally received by the CRA prior to 1 March 2018. Thus, if a taxpayer wants to take advantage of the existing no-name disclosure policy, the application will have to be made well in advance of 28 February 2018.

Immediate payment required: Under the new circular, "the taxpayer must include payment of the estimated tax owing with their VDP application," although the applicant "may request to be considered for a payment arrangement subject to approval from CRA Collections officials." The requirement for payment is presented as an essential condition of a valid application, on the same level as voluntariness, completeness, application of a penalty and the inclusion of information at least a year past due.

The new circular does not specify what happens if a taxpayer makes a complete disclosure but cannot reach an agreement with CRA Collections on a payment arrangement, i.e., if this will cause the disclosure to be denied. The current circular is silent on payment issues.

This payment requirement may cause significant hardship in cases where the disclosure involves the payment of tax that is refundable. For example, suppose a Canadian corporation made a loan to a foreign shareholder (or person related to the foreign shareholder) that was not repaid by the end of the following taxation year of the Canadian corporation but was repaid thereafter. The failure to repay the loan gives rise to a deemed dividend under paragraph 214(3)(a) of the Act, for which Part XIII withholding tax is payable. However, the repayment of the loan should give rise to a refund of the Part XIII tax under subsection 227(6.1). Under the current circular, it may be possible to coordinate the payment of the Part XIII tax and its refund in order to minimize cash flow concerns. However, under the new circular, the Part XIII tax estimated to be payable must be paid at the outset, unless a payment arrangement can be made with CRA Collections officials.

Disclosure of advisor: The new circular notes that if "a taxpayer received assistance from an advisor in respect of the subject matter of the VDP application, the name of that advisor should generally be included in the application." There is no mention of relief for the advisor from the planning or preparer penalty under section 163.2 or from criminal prosecution under section 239 of the Act. Therefore, it may be necessary for the advisor to make a VDP

application on his or her own behalf if the taxpayer's application could create a risk of such penalties or prosecution.

The current circular does not mention disclosure of advisors.

Lessons learned

On a practical level, because the new circular comes into effect on 1 March 2018 and only applies to applications received on or after that date, there is still time to make use of the provisions of the current circular. Particularly for a taxpayer that is a large corporation or sophisticated (i.e., where there is "an element of intentional conduct" in the non-compliance), filing a named VDP application prior to 1 March 2017 may protect the taxpayer and ensure it does not fall into the Limited Program, which does not provide relief from late-filing penalties and any interest relief.

Learn more

To learn more about the changes to the CRA's VDP policy, contact your local EY Private Client Services professional at ey.com.ca/private or one of the following professionals:

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