



Coming clean with the tax authorities – making a Voluntary Disclosure

Canada's tax system is a self-assessing one. Each spring, individual Canadians are required to gather together the necessary information, complete a T1 Individual Income Tax and Benefits Return and submit that return to the Canada Revenue Agency (CRA) on or before the required deadline. That deadline is April 30 for most individual taxpayers and June 15 for self-employed taxpayers and their spouses. And, of course, where that return shows that there is an income tax balance payable for the previous taxation year, that balance must be paid in full, by all individual taxpayers, on or before April 30.

Given the number of taxpayers involved, the complexity of Canadian tax laws and the



general distaste felt by most Canadians when it comes to the need to complete and file the annual return (or worse, to send money to the government), the degree of compliance is somewhat remarkable. According to CRA figures, over 98% of Canadians file their tax returns and make required payments on a timely basis.

While that level of compliance is obviously welcome, even a 98% compliance rate still leaves a lot of tax returns unfiled and/or tax payments unpaid. For the 2016 taxation year, just over 28 million tax returns were filed by individual Canadians. If that figure represents 98% of required filings, that means that, for the 2016 tax year, several hundred thousand returns weren't filed as required. Where there was a tax balance owed for the 2016 tax year, that also means that the required tax payment wasn't made on time.

In most instances, the delinquent taxpayer will be subject to both interest and penalties in respect of that failure to file and/or pay.

What interest and penalties?

Most Canadians are likely aware, in a general way, that where they owe money to the government, interest charges will be levied. Few, however, are aware of the rates that will apply, just how those interest charges are calculated and how quickly such charges can add up. And probably relatively few realize that penalties as well as interest can be imposed – and that interest is payable on those penalties!

When it comes to the annual tax return filing and payment requirements, the penalty/interest regime works in this way.

Regardless of whether their filing deadline is April 30 or June 15, all individual taxpayers must pay any income taxes owed on or before April 30. Where that payment is not made, interest is charged on the outstanding amount of taxes owed, beginning on May 1. The rate charged by the CRA is, by law, higher than ordinary commercial interest rates. For the fourth quarter of 2017 (October 1 to December 31) the rate imposed is 5%. As well, any interest charges levied by the CRA are compounded daily, meaning that on each successive day, interest is levied on the previous day's interest charge.

Where an individual does not file his or her return by the deadline imposed (April 30 or June 15, depending on the taxpayer's circumstances) a late-filing penalty of 5% of any outstanding tax amount owed is levied the day after the filing deadline (so May 1 or June 16). An additional late-filing penalty of 1% of the outstanding balance is also levied for each full month that a return remains unfiled, to a maximum of 12 months. Consequently, the late-filing penalty can reach 17% of any tax amount owed but unpaid.

Where the taxpayer fails to file on a repeated basis, the late-filing penalties imposed get a lot worse. If the CRA charged a taxpayer with a late-filing penalty with respect to his or her return for 2013, 2014, or 2015, the late-filing penalty that is imposed where the return for 2016 isn't filed on time is doubled. Specifically, the late-filing penalty for 2016 would be 10% of the 2016 balance owing,

plus 2% of that balance for each full month the return is late, to a maximum of 20 months. A bit of arithmetic shows that where a taxpayer is subject to that second occurrence penalty and he or she incurs the maximum penalty, that total penalty amount can reach 50% of the actual tax amount owed.

An example of that worst-case scenario looks like this:

A taxpayer who was assessed a late-filing penalty with respect to his 2013 tax return fails to file his return for 2015. The tax balance owing on that return is \$1,000. The penalty charges imposed where that return has not been filed by the end of 2017 are as follows:

\$100 — initial 10% late-filing penalty imposed on May 1, 2016

\$400 — \$20 per month for the 2% per month late-filing penalty times 20 months (May 1, 2016 to December 31, 2017)

\$500 — total late-filing penalty charges levied.

In addition, throughout the entire period from May 1, 2016 to December 31, 2017, interest is levied (and compounded daily) on both the original tax amount unpaid and on any penalty amounts levied to date. The total interest and penalties assessed will be well in excess of 50% of the original tax amount owed.

Given the punitive interest and penalty amounts to which they are subject, it's not hard to see that individual taxpayers who have fallen into arrears with respect to their tax filing and payment obligations might welcome the opportunity to stop the interest and penalty clock running and to get out from under everything. Perhaps surprisingly, that's also the perspective of the CRA. While the CRA has a great number of enforcement and collection options and powers at its disposal, the fact remains that significant time and resources are required to track down delinquent taxpayers and to collect amounts owed — where they can be collected at all. Consequently, it's also in the CRA's interest to make it possible for such taxpayers to come forward voluntarily and get their tax affairs brought up to date and in good standing. And that process is the CRA's Voluntary Disclosure Program.

What is the Voluntary Disclosure Program?

Simply put, the CRA's Voluntary Disclosure Program is one in which taxpayers who are in arrears of their tax filing and payment obligations (or who have filed a return or returns in which their income and deductions/credits were not accurately reported) can come forward and pay the related tax amounts owing, but have some or all of any penalty amounts levied (and, in some cases, partial interest amounts charged) waived. As well, taxpayers who come forward as part of the Voluntary Disclosure Program can be assured that they will not be subject to criminal prosecution for their tax defaults.

The VDP is an administrative program of the CRA, meaning that taxpayers apply to the CRA to be considered for the program, and that a decision of whether or not the taxpayer qualifies is entirely at the discretion of the Agency.

Who can apply to the VDP?

All Canadian taxpayers are eligible to apply for relief under the VDP, but there are restrictions on the kinds of circumstances in which relief may be granted and the time periods for which relief is available.

Generally, the VDP applies to disclosures relating to income tax, excise tax, goods and services tax, harmonized sales tax, Excise Duties under the Excise Act and charges under the Air Traveller's Security Charge Act. Relief under the Program can be considered by the CRA in relation to any of the following actions of a taxpayer:

- failing to fulfill obligations under the *Income Tax Act*;
- failure to report any taxable income received;
- claiming ineligible expenses on a tax return;
- failing to file information returns, or
- failing to report foreign source income that is taxable in Canada.

There are also circumstances in which an individual's application for relief under the VDP will not be considered by the Agency,



and those include the following:

- applications that relate to income tax returns with no taxes owing or with refunds expected, as such returns would be dealt with through normal CRA return processing procedures;
- applications reporting income from proceeds of crime;
- applications involving previous taxpayer elections to choose specific tax treatment of certain transactions;
- applications where the taxpayer has become bankrupt; and
- post-assessment requests for penalty and interest relief.

Time Limits on a VDP application

In addition to the limitations on the factual circumstances in which the Voluntary Disclosure Program will or will not be available, there are time limits imposed. First of all, VDP applications can be made only with respect to returns which are at least one year overdue. Where a taxpayer has made an error or omission with respect to a return that was due within the previous 12 months, the way to correct such error or omission is to file a T1 Adjustment Request with the CRA. The prescribed form for doing so can be found on the CRA website at <https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/change-your-return.html>.

Finally, an application to the VDP can only go back ten years. More specifically, the Minister's ability to grant relief with respect to penalties is limited to any taxation year (for individual taxpayers, this is always the same as the calendar year) that ended within the 10 years before the calendar year in which the VDP application is made. So, where an application is made during 2017, any relief requested and granted can only be in respect of the 2007 and subsequent tax years.

The applicable time period is a little more flexible when it comes to forgiveness of interest amounts levied. Here again, the Minister's ability to grant relief is limited to interest that accrued during the 10 calendar years before the calendar year in which the VDP application

is made. However, the year in which the tax debt which gave rise to the interest charges need not fall within that 10 year period. So, while the Minister can grant relief with respect only to interest charges levied in 2007 and later years (where the VDP application is made in 2017), the tax debt in respect of which those interest charges are levied could have been incurred in any year before 2007.

What does "Voluntary" mean?

As the name clearly states, an application made under the VDP program is one which is initiated by the taxpayer of his or her own accord. However, for purposes of the VDP, the term "voluntary" has a more expansive meaning than is usually the case.

Essentially, what is required is that the taxpayer's decision to come forward not be made with knowledge of, or in consequence of any enforcement action by the CRA. In the Agency's view, once such action on its part has come to attention of the taxpayer, any subsequent disclosure is not truly voluntary.

In that regard, the CRA has a very specific and very broad definition of the terms "voluntary" and "enforcement". In the CRA's view, a disclosure is not truly voluntary and cannot qualify under the VDP if the following are true:

- the taxpayer was aware of, or had knowledge of an audit, investigation or other enforcement action set to be conducted by the CRA or any other authority or administration, with respect to the information being disclosed to the CRA, or
- enforcement action relating to the subject matter of the taxpayer's VDP application was initiated by the CRA, or any other authority or administration, against the taxpayer, or a person associated with, or related to, the taxpayer (which includes, but is not limited to, corporations, shareholders, spouses and partners), or against a third party, where the purpose and impact of the enforcement action against the third party is sufficiently related to the taxpayer's VDP application.

Similarly, the CRA defines “enforcement actions” to include any or all of the following:

- requests, demands or requirements issued by the CRA relating to unfiled returns or unremitted taxes or instalment payments of tax; in addition, although such actions may only pertain to one specific year, the procedure will be considered to be an enforcement action, for purposes of the VDP, for all taxation years;
- requests, demands or requirements which have been issued with reference to other tax affairs of the taxpayers, partners of the taxpayer, trusts in which the taxpayer is a settlor, trustee or beneficiary, or corporations associated with or related to the taxpayer;
- direct contact by a CRA employee for any reason relating to non-compliance (for example, unfiled returns, audit, collection issues); and/or
- an audit investigation or other enforcement action by another authority or administration, including a police force or securities commission.

her. As an example of such circumstances, the CRA points to a situation in which a taxpayer was subject to a recent audit with respect to harmonized sales tax/goods and services tax (HST/GST). In the Agency’s view, where the same taxpayer submits a VDP application in respect of a different kind of tax liability for the same year and there is, in the Agency’s view, no correlation between the two tax issues, the enforcement action with respect to GST/HST may not be cause to deny the VDP application.

Testing the waters – making a “no-names” disclosure

No matter how much money is involved, or how many tax years, it’s undeniable that the prospect of disclosing one’s past tax transgressions to the tax authorities can be unnerving. The CRA recognizes that fact, and its solution is to allow taxpayers to test the waters, so to speak, by making what is called a “no-names disclosure”. Effectively, that process allows the taxpayer to provide all relevant information about past non-compliance to the Agency, without disclosing personal identifying information, and to then obtain information on how the VDP might apply in their particular circumstances.

The purpose of a no-names disclosure is, for the most part, informational in nature, as any discussions which take place are not binding on the Agency and do not constitute acceptance into the VDP. As well, the CRA’s participation in a no-names disclosure process does not impact the Agency’s ability to audit, penalize or refer a case for criminal prosecution.

Making the application

The CRA has a well-defined process for taxpayers who decide to proceed with a formal application under the VDP. Such taxpayers use a prescribed form – Form RC199, Voluntary Disclosure Program (VDP) Tax Agreement, which is available on the CRA website at <https://www.canada.ca/en/revenue-agency/services/forms-publications/forms/rc199-voluntary-disclosures-program-taxpayer-agreement.html>.

The RC199 requires the taxpayer to provide

Notwithstanding these significant restrictions, there are still circumstances in which a taxpayer may continue to be eligible for the VDP even though the CRA has commenced enforcement action against him or



the following information:

- the taxpayer's name, address, postal code, telephone number and tax identification number;
- the address of the taxpayer's authorized representative, including telephone and fax numbers (if applicable);
- whether the taxpayer has made a previous application under the VDP;
- the taxation year(s) or fiscal period(s) involved;
- the amount of income or gain (if any) involved;
- type of return(s) involved;
- type of information return(s) involved;
- type of income omitted;
- whether the income was from a foreign source and, if yes, the jurisdiction(s) involved;
- the reason for the omission;
- proof of payment; and
- an explanation of how the taxpayer considers that the five prerequisite conditions for the VDP have been met. Those five conditions are that the application be voluntary and complete, that it involves the application or potential application of a penalty, that it includes information that is at least one year overdue and that it includes payment of the estimated tax owing.

An application under the VDP can be submitted online by taxpayers who have previously registered for the CRA's My Account or My Representative services, or can be faxed to 1-888-452-8994.

The CRA has centralized its administrative functions with respect to the VDP at its office in Shawinigan Quebec. VDP applications can therefore be sent by regular mail to that office at the following address:

Voluntary Disclosures Program
Shawinigan National Verification and
Collections Centre
4695, Shawinigan-Sud boulevard
Shawinigan, QC G9P 5H9

What kind of relief is available – the Limited and General Programs

Although there is only one form for all applications to the VDP, there are in fact two programs under which VDP relief can be provided by the CRA – the Limited and General Programs.

As the names imply, there is a difference with respect to the extent of the relief from interest and penalties which is granted by the CRA under each Program. (Note that the option as to which Program, if either, applies is solely that of the CRA and the taxpayer has no input into that decision.)

Where an application is accepted and found to qualify under the General Program, the taxpayer will not be charged penalties, and may be granted partial relief with respect to interest amounts charged. Usually, that interest relief will cover 50% of the interest charged for the years preceding the three most recent years of returns required to be filed. Full interest charges will, however, be levied with respect to the three most recent years of returns required to be filed.

Where the CRA determines that the taxpayer's circumstances qualify for relief only under the Limited Program, the taxpayer will not be subject to criminal prosecution, or charged penalties for gross negligence. However, all other applicable penalties will be charged, and no interest relief will be provided.

Generally speaking, the CRA will find that a VDP application qualifies for relief only under the Limited Program where large dollar amounts are involved, there have been multiple years of non-compliance, the taxpayer has engaged in active efforts to avoid detection (including the use of offshore vehicles) and/or the taxpayer is, in the CRA's view, a sophisticated taxpayer. Generally, the CRA will restrict relief to that available under the Limited Program where there is a "high degree of taxpayer culpability" which contributed to the failure to comply.

What is an "Effective Date of Disclosure"?

Generally speaking, a taxpayer is (assuming that all necessary prerequisites have been

met) provided with protection under the VDP, with respect to amounts disclosed, as of the date that the CRA receives the taxpayer's completed and signed VDP application. That date is the "Effective Date of Disclosure" or EDD. Where additional information is required to complete the application, the taxpayer can have up to 90 days from the date of the EDD to provide that information. The taxpayer can also, where necessary, request an extension of that 90-day period.

If the taxpayer does not provide the necessary information or documentation within that 90-day period (or any extension provided), the CRA may then proceed with enforcement action against the taxpayer.

Moving forward – the disclosure process

Once the taxpayer (or his or her representative) has submitted the VDP application they must await a written response from the CRA. Where the CRA accepts the taxpayer's application to the VDP, that written response will include the following information:

- verification that the application has been accepted into either the General or Limited Program;
- a list of taxation years are eligible for VDP relief;
- the Effective Date of Disclosure;
- verification of whether the information disclosed may be referred to another CRA program area; and
- verification that the information disclosed will be sent to the appropriate area for processing the assessment or reassessment.

The CRA may, of course, determine that the taxpayer has not met the five prerequisite conditions for the VDP or that the circumstances are such that the VDP application will not be considered. In that eventuality, the taxpayer will be advised, in writing, of the following:

- the application has been denied;

- the disclosed information may be referred to another CRA program area;
- the disclosed information may result in an assessment or reassessment;
- penalties and interest may be levied; and
- in certain circumstances, an investigation and prosecution may be initiated.

Appeal rights when approval is denied

Where the Agency rejects the taxpayer's VDP application, or the taxpayer is dissatisfied with the extent or nature of the relief which the Agency is willing to provide, it's not possible to object in the same way as can be done with respect to an ordinary assessment issued by the tax authorities. The VDP program does, however, provide for a mechanism through which the taxpayer can ask to have the original decision reconsidered at a higher level in the Agency. Where either the initial or second level decision is not to the taxpayer's liking, and he or she believes that the Minister's discretion was not exercised in a fair or reasonable way, it's possible to ask for a Court review of that decision. The Court's authority in such circumstances is, however, limited to setting aside the Minister's decision and returning the matter to the CRA for fresh consideration.

There's no doubt that the prospect of disclosing past tax transgressions to the tax authorities is stressful for any taxpayer. And, of course, no matter how "favourably" those tax authorities look upon the taxpayer's situation, the inescapable reality is that any outstanding tax amounts will have to be paid, along with at least some of the interest charges which have accrued. Taxpayers who are contemplating making a voluntary disclosure to the CRA should think about obtaining advice from a tax professional before doing so: where there are multiple taxation years or a large amount of taxes involved, such professional advice and representation are essential.