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August 16, 2012
Number 2110

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WHEN IS VOLUNTARY DISCLOSURE VOLUNTARY?

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In the recent decision of *Worsfold v. The Queen* (2012 FC 644), the Federal Court held that a taxpayer's disclosure under the Voluntary Disclosures Program (the "VDP") was "voluntary", even though the Canada Revenue Agency (the "CRA") had started an enforcement action against a related party. *Worsfold* confirms that a link between the enforcement action and the disclosed information is what is important — not a link between the parties — when considering whether a disclosure made alongside an existing enforcement action is voluntary. Also, given that the sequence of events was integral to the findings in this case, this decision underscores the importance of keeping detailed records at every stage of a voluntary disclosure.

VDP

As most tax practitioners know, the VDP allows taxpayers to voluntarily correct inaccurate or incomplete information, or disclose information not previously reported in previous dealings with the CRA. In order to be "valid", a disclosure must meet four conditions: (i) it must be voluntary, (ii) it must be complete, (iii) it must involve the application or potential application of a penalty, and (iv) it must generally include information that is more than one year overdue. If the taxpayer's disclosure is accepted as valid, the Minister may exercise her discretion under subsection 220(3.1) of the *Income Tax Act* (the "Act")[1] to cancel or waive penalties or interest otherwise payable under the Act.[2] As the VDP is purely an administrative program, no appeal to the Tax Court is available if the CRA decides that the disclosure does not satisfy the four requirements. Instead, a dissatisfied taxpayer may request a second level review within the CRA, and if the disclosure is again deemed invalid, the taxpayer may apply for judicial review to the Federal Court on the basis that the decision is unreasonable.

Worsfold

In *Worsfold,* the principal applicant was a permanent resident of Canada who had not filed any tax returns or reported income to the CRA since his arrival to Canada in 2001. He was a director of a Canadian company (Stoneridge Inc.) in which he held a non-controlling, indirect, one-third interest. He was also the sole director and shareholder, and employee, of a British Virgin Islands company that provided management consulting services. The other applicants were his wife, the British Virgin Islands company, and a family trust whose trustees included the principal applicant and his wife.

In this case, the timeline of events was important. The principal applicant had contacted a tax lawyer in September 2005 about "tax amnesty", after which he scheduled a

meeting with the lawyer for October 5, 2005. Two days before the scheduled meeting, a CRA auditor advised Stoneridge Inc.'s secretary that the CRA was planning an audit of Stoneridge Inc. On October 5, 2005, the principal applicant met with the tax lawyer, who, on the same day, submitted a voluntary disclosure on the principal applicant's behalf. The other applicants' disclosures were submitted later in connection with the primary applicant's disclosure.

At both the first and second level review stages, the CRA decided that all of the applicants' disclosures were invalid because they were not voluntary. The primary reason given was that the CRA had initiated an audit on a related taxpayer (i.e., Stoneridge Inc.) prior to the date of the disclosures. The CRA policy documents applicable at the time provided that, in determining whether a disclosure was voluntary, an officer could consider whether it was made with the knowledge of an audit, investigation, or other enforcement activity that had been initiated by the CRA, and in some cases, could consider whether there had been enforcement activity on "related program lines, partners of the taxpayer, or corporations related to the taxpayer". Further, the CRA's internal VDP Guidelines stated that if a VDP officer discovered that enforcement actions had been taken against a disclosing taxpayer, the following questions should be asked:

- Was any direct contact made with the client or is the client likely to have been aware of the enforcement action?
- Is it likely that the CRA would have uncovered the information being disclosed based on this enforcement action?

If the answer to either of these questions is "No", the disclosure may be considered voluntary. Clients should be given the benefit of the doubt.

Significantly, in the second level review decision, the VDP officer noted that it was reasonable to expect that the secretary or accountant of Stoneridge Inc. would have immediately informed the principal applicant about the audit of the company. Thus, it was also reasonable to conclude that the principal applicant's disclosure was made with knowledge of the audit. With respect to the other applicants, the VDP officer found that their disclosures were not voluntary because it was reasonable to believe that their information disclosed to the CRA would have been discovered during the course of the Stoneridge Inc. audit. The applicants applied for judicial review.

At the Federal Court, the applicants argued that the VDP officer's decision was based on two unreasonable findings of fact: (i) the principal applicant had knowledge of the Stoneridge Inc. audit, and (ii) the CRA, through the Stoneridge Inc. audit, would have uncovered the disclosed information because the applicants were related to Stoneridge Inc. The applicants also argued that the VDP officer failed to follow the VDP Guidelines in considering whether the existence of the Stoneridge Inc. audit invalidated their disclosures.

The Court found the VDP officer's decision to be unreasonable for two reasons. First, there was no evidence that any of the applicants knew of the Stoneridge Inc. audit on the effective date of disclosure. On the contrary, the evidence showed that the principal applicant was the one who initiated the voluntary disclosure process. The Court also noted that the VDP officer essentially ignored the principal applicant's evidence regarding his initiation of the VDP process and did not give any of the applicants the "benefit of the doubt", despite the recommendation contained in the VDP Guidelines.

Second, the Court found that the VDP officer failed to address the second question in the VDP Guidelines, which asked whether the CRA would have uncovered the information during the Stoneridge Inc. audit. Rather, the VDP officer looked only at the relationship between some of the parties. Relying on *Poon v. Canada* (2010 DTC 5191), the Court held that the VDP officer's failure to address the second question rendered the decision unreasonable. The decision was sent back to the Minister for reconsideration.

Analysis

As mentioned above, *Worsfold* confirms the importance of the link (if any) between an enforcement action and the disclosed information. A mere link between the parties is not enough to disqualify an otherwise valid disclosure. The sequence of events in *Worsfold* — the narrow window of time in which certain activities occurred — highlights the importance of keeping detailed records at every stage of a process involving the CRA.

Several other points arise from the Court's decision in *Worsfold*. First, the Court rejected the Minister's argument that the word "related", as used in the VDP Guidelines, is not limited to the definition found in section 251 of the Act and should be interpreted to mean "a relationship between two or more persons of a somewhat close nature". Although

the Court did not discuss this issue in detail, it is clear that its finding that Stoneridge Inc. was not a related party was based on the definition found in the Act.

Second, the Court did not address directly why the VDP officer was required to answer the questions in the VDP Guidelines, even though Information Circulars and Guidelines are not delegated legislation and have no force of law (*Karia v. MNR* (2005 DTC 5282); *Maple Lodge Farms v. Government of Canada* ([1982] 2 SCR 2)). The Court simply relied on *Poon* in holding that the VDP officer's failure to address the questions in the VDP Guidelines was unreasonable. Presumably, the CRA can depart from its own VDP Guidelines in appropriate circumstances (and the nature of such circumstances may be the subject of another case).

Last, although the provision giving taxpayers the "benefit of the doubt" has been removed from the current VDP Guidelines, the Court's decision in *Worsfold* may encourage the CRA to think twice before attempting to draw negative inferences against a taxpayer.

A number of tax lawyers from Fraser Milner Casgrain LLP write commentary for CCH's Canadian Tax Reporter *and sit on its Editorial Board as well as on the Editorial Board for CCH's Canadian* Income Tax Act with Regulations, Annotated. *Fraser Milner Casgrain lawyers also write the commentary for CCH's* Federal Tax Practice *reporter and the summaries for CCH's* Window on Canadian Tax. *Fraser Milner Casgrain lawyers wrote the commentary for* Canada–U.S. Tax Treaty: A Practical Interpretation *and have authored other books published by CCH:* Canadian Transfer Pricing *(2nd Edition, 2011);* Federal Tax Practice; Charities, Non-Profits, and Philanthropy Under the Income Tax Act; *and* Corporation Capital Tax in Canada. *Tony Schweitzer, a Tax Partner with the Toronto office of Fraser Milner Casgrain LLP, and a member of the Editorial Board of CCH's* Canadian Tax Reporter, *is the editor of the firm's regular monthly feature articles appearing in* Tax Topics.

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Notes:

[1] *Income Tax Act*, RSC 1985, c. 1 (5th Supp.) as amended, or similar rules under other revenue statutes.

[2] Under the VDP in effect at the time of the decision, the CRA would waive penalties, but interest would be waived only under a separate application under the Fairness Package, now the Taxpayer Relief Package.