THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

August 9, 2017

Via email: vdpconsultsg@cra-arc.gc.ca

Voluntary Disclosures Program
Domestic Compliance Programs Branch
Canada Revenue Agency
Ottawa, ON K1A 0L5

Dear Madam or Sir:

Re: Proposed Changes to the Voluntary Disclosures Program – Draft GST/HST Memorandum 16.5

I am writing on behalf of the Canadian Bar Association's Commodity Tax, Customs and Trade Section (CBA Section) to comment on the Draft GST/HST Memorandum 16.5 – Voluntary Disclosures Program (Draft Memorandum).

The CBA is a national association representing over 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. We promote the rule of law, access to justice, effective law reform and provide expertise on how the law touches the lives of Canadians every day. The CBA Section comprises lawyers from across Canada who work on commodity tax, customs and trade remedy matters.

A. Introduction

In August 2016, we wrote to Kevin Morgan, Manager, Voluntary Disclosures Program at the Canada Revenue Agency (CRA) about the Voluntary Disclosures Program (VDP). We are pleased that some of our suggestions have been considered. We are also pleased to provide the following comments and recommendations on the Draft Memorandum to further improve the VDP.[1]

B. Unique Context of GST/HST Regime

The GST/HST regime is very different than the income tax regime. It is generally structured to make the supplier responsible (as agent of the Crown) for properly charging, collecting and remitting the GST/HST. In our experience, it is usually suppliers that are audited by the CRA for failing to collect GST/HST, rather than taxpayers for failing to pay the GST/HST.

[1] Our comments are limited to GST/HST.

Further, unlike for income tax purposes, there are very few "sophisticated GST/HST plans" as the risks invariably fall on the supplier as the person responsible for any shortfall in GST/HST remittable. Accordingly, the VDP is almost exclusively used by suppliers to correct inadvertent errors in charging, collecting or remitting the GST/HST.

We are cognizant of the VDP's goal of not rewarding non-compliance and not allowing registrants to intentionally avoid their legal obligations. However, the VDP should not put taxpayers in a worse situation than if the issue in question was discovered on audit rather than voluntarily disclosed.

Unlike taxpayers who do not comply with the income tax rules, suppliers do not generally benefit from their non-compliance. Given that suppliers perform an important role in collecting and remitting GST/HST as agent of the Crown, the CRA should be careful to ensure that suppliers have every incentive to utilize the VDP to correct past errors, and that the VDP process is efficient, well-coordinated and provides certainty of outcome.

This unique aspect of the GST/HST regime underlies our comments and recommendations below.

C. Clarifications on the Three "Track" Approach

Before addressing the three tracks in detail, we suggest that, when determining the applicable track, there should be some flexibility and discretion to take into account extraordinary circumstances of the non-compliance. For example, a company's non-compliance that appears to fall under Track 3 may have arisen through the actions of a rogue employee. If the non-compliance was disclosed and corrected by the applicant as soon as it was discovered, the circumstances of that particular case should be considered to allow a more lenient treatment.

Additionally, there may be cases where different features of different tracks may be appropriate. The CRA should reserve its flexibility and not fetter its discretion. For example, in the rogue employee case cited above, the appropriate treatment could involve full interest relief, which is not currently contemplated for non-wash transactions.

Although the tracks provide appropriate guidelines for determining the treatment of taxpayers in most circumstances, the VDP should be flexible enough to permit special treatment in demonstrably special circumstances.

D. Comments on the Specifics of the Three Tracks

1) Track 3 is Overly Broad and Criteria are Vague

It appears that the only benefit of Track 3 is the avoidance of prosecution and gross negligence penalties. However, in our experience, most GST/HST registrants who want to use the VDP are businesses that made honest errors and want to clean up past issues and comply going forward. For many of these businesses, the issue is their failure to collect tax from customers. In these cases, they generally have not received any benefit from the failure to collect (rather the purchaser obtained the benefit).

We are most concerned that the broad criteria for Track 3 will discourage taxpayers from coming forward. In our view, Track 3 should be limited to circumstances involving either (i) taxes collected that have not been properly reported and remitted, or (ii) "major non-compliance", involving "a high degree of registrant culpability". These circumstances would include "active efforts to avoid detection" and "deliberate or wilful default or carelessness amounting to gross negligence". In these circumstances, the limited relief provided by Track 3 is appropriate.

However, in our view, a "large dollar amount", "multiple years of non-compliance" and "sophisticated registrant" are not relevant factors for determining the culpability of a GST/HST registrant. Further, sophisticated registrants can just as easily make inadvertent errors as unsophisticated registrants, in that they often deal with the most complex provisions of the *Excise Tax Act*[2] and have extremely complex sales and accounting systems (that deal with hundreds or thousands of different products and an even greater number of transactions).

These types of entities should not automatically be placed into Track 3 as a result of making such errors. In our view, if these conditions are not removed, very few large corporations will make voluntary disclosures for GST/HST because they will most likely fare worse under Track 3 than they would in an audit.

In instances where the error is longstanding (i.e., goes back more than four years) and does not involve misrepresentation due to neglect, carelessness, wilful default or fraud, the supplier's potential GST/HST liabilities under Track 3 would be greater if the supplier voluntarily disclosed the error, than if the supplier assumed the risk of a normal GST/HST audit.

Where the non-compliance involves the failure to collect tax, there is also no guarantee that the supplier will be able to recover the tax from its customers, particularly where they are consumers or businesses that no longer exist. Therefore, in addition to bearing full interest and regular penalties, suppliers have to bear the tax otherwise payable by their customers. The possibility of clients finding themselves in a worse position if they come forward, particularly since they would be saving the CRA the expense of a normal audit, makes it difficult to encourage a voluntary disclosure.

The criteria of "large dollar amount" and "sophisticated registrant" are also ambiguous and open to interpretation. The Draft Memorandum does not provide any guidelines or definitions of these criteria. This unnecessary uncertainty will discourage taxpayers involved in non-wash transactions from using the VDP, as it will be difficult for them to know whether they will be accorded Track 2 or Track 3 treatment. Additionally, it may be awkward and belittling to require a taxpayer to demonstrate that it is not "sophisticated" in order to avoid Track 3 treatment.

We have difficulty understanding how the Track 3 criterion to capture disclosures "made after an official CRA statement regarding its intended focus of compliance or following CRA correspondence or campaigns" applies to GST/HST matters. In our view, it is meant to apply to income tax matters and is not applicable to GST/HST. For example, if the CRA makes a statement that it intends to audit the construction industry more carefully, it would be irrational for a construction company's voluntary disclosure to be automatically referred to Track 3.

It is not reasonable to expect taxpayers to make voluntary disclosures if the terms are substantially worse than could be expected on audit. The construction company in this example should still be able to benefit from Track 1 treatment (if it meets the criteria) or Track 2 treatment in the absence of any major non-compliance involving a high degree of registrant culpability. In our view, this criterion does not provide any assistance in determining the degree of culpability of a registrant, and should be removed.

In our experience, the majority of GST/HST voluntary disclosures are made on behalf of sophisticated taxpayers with large dollar issues that span multiple years. If these taxpayers are included in Track 3, they have incentive to wait and see whether the issues are caught by an

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[2] For example, Selected Listed Financial Institutions (SLFI) rules for large financial institutions.

auditor - in which case the assessment will generally be limited to four years (if they are even discovered in the first place).

2) Track 1 is Overly Narrow

The CRA has recognized that the GST/HST system gives rise to "wash transactions", meaning that if the supplier properly charged the appropriate amount of GST/HST, the recipient (taxpayer) would have received a full refund of such taxes anyway, by way of input tax credit (i.e., resulting in no loss of revenue to the government). The CRA's position is that the interest imposed on wash transactions should be limited to 4% of the GST/HST owing, where the CRA's conditions are met. The current VDP allows for full interest and penalty relief when a wash transaction is disclosed, but not tax relief.

As wash transactions involve no loss of government revenue, we believe it is unfair to burden the supplier with the responsibility to remit the GST/HST at issue and put the supplier at risk of recovering such GST/HST from its customers. Customers often resist making payments when issued a "tax-only" invoice. Many suppliers forego invoicing their customers for these amounts for fear of harming the relationship. Further, in some cases, the customers have become bankrupt or no longer exist.

Example: *Supplierco sold products to a company that has now gone bankrupt (Bankruptco), over a four year period.*[3] *Supplierco took the position that certain products were zero-rated but subsequently determined that those products were taxable and it should have charged an additional $100 of GST per month. Bankruptco would have received full input tax credits so the sales were wash transactions.*

If Supplierco makes a Track 1 voluntary disclosure, it will be required to pay $4,800 of GST (i.e., $100 per month over four years). The 4% wash penalty (i.e., $192) should be waived. However, because Bankruptco will likely not pay Supplierco the GST, Supplierco is, on the whole, better off not making a voluntary disclosure. Every month that passes without an audit and assessment represents additional savings of $100 to Supplierco, which, after only two months, is a greater benefit to Supplierco than the waiver of the wash penalty.

In addition, requiring the parties to go through the motions of invoicing, collecting and paying the GST/HST and then claiming input tax credits imposes an unnecessary and costly administrative burden with no apparent benefit to any of the parties or the CRA.

We recommend that GST/HST not be assessed against the supplier in Track 1, where there is no loss of government revenue. Rather, if the voluntary disclosure is accepted, the supplier should be cleared of potential liability for taxes, interest and penalties. Since the VDP may not be used twice for the same issue, there is no risk that suppliers will make multiple voluntary disclosures for the same error. We understand that the CRA is not permitted by law to waive the application of taxes, but in our view, if a registrant is accepted into Track 1, the taxes do not have to be assessed in the first place, so no waiver of taxes would be required.

Additionally, we recommend that Track 1 relief not be limited to the narrowly defined wash transactions in GST/HST Memorandum 16.3.1. Rather, Track 1 relief should be allowed in all circumstances where the registrant discloses that the taxes have not been remitted properly, but demonstrates that there is no loss of revenue to the government. For example, in cases where a

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[3] Several high profile retail companies have gone bankrupt in recent years and the risk of bankruptcy or non-payment by customers is a significant concern for suppliers making a voluntary disclosure.

third party agent remits GST/HST instead of the principal, Track 1 relief should be applied to the principal because there is no loss of revenue to the government. Another example is where input tax credits for GST on importation were claimed by an agent (i.e., the entity listed as the importer of record), instead of the *de facto* importer.

To establish that there was no loss of revenue to the government, additional parties may have to communicate with the VDP, aside from the registrant making the voluntary disclosure. In the example above, the agent should be able to communicate with the VDP officer to establish that it remitted the GST/HST that should have been remitted by the principal.

We recommend that the VDP be flexible enough for multiple parties to make a single voluntary disclosure in order to establish all of the relevant facts. This would improve efficiency and provide incentives for taxpayers to use the VDP.

3) Track 2 Disclosures should be Limited to Four Years, not Six Years

As noted above, the risk of a normal GST/HST audit is limited to four years. Only in exceptional circumstances may an auditor look beyond the four-year limitation period. We suggest that it is not reasonable to expect taxpayers to make a voluntary disclosure under Track 2 if the terms are substantially worse than could be expected on audit.

This is particularly so as the vast majority of disclosures under Track 2 will likely relate to GST/HST that the supplier failed to collect from third parties who are not entitled to input tax credits. As such, in most cases it will be difficult, if not impossible, to go back to customers to collect the tax.

For this reason, we recommend that the standard limitation period for a Track 2 voluntary disclosure be limited to four years, not six. If Track 2 is not limited to four years, we would expect a significant reduction in voluntary disclosures by taxpayers who have non-wash transactions that extend beyond the normal four-year audit period.

At first, it might appear that a supplier making a voluntary disclosure in these circumstances would be better off than a compliant taxpayer as it would only have to bear 50% interest. However, also factoring in the probability that the supplier will have to bear at least part of the GST/HST collectible, and that two additional years will be assessed (and 50% interest on these years), it becomes increasingly likely that a supplier making a voluntary disclosure will be in worse position than a supplier who chooses to take its chances with a CRA audit. This is contrary to the main principle of the VDP set out in paragraph 5 of the Draft Memorandum of "encouraging taxpayers to voluntarily come forward and correct any previous errors or omissions in their tax affairs."

E. "No-Name" Voluntary Disclosures Should Still Protect Taxpayer

Paragraph 40 of the Draft Memorandum provides that "no-name" pre-disclosure discussions may take place. However, paragraph 41 states that these discussions do not constitute acceptance into the VDP and have no impact on the CRA's ability to audit, penalize or refer a case for criminal prosecution.

Under the current VDP regime, the effective date of disclosure (EDD), is the date that the application for the voluntary disclosure is filed, whether on a named or no-name basis. The EDD is the date from which the taxpayer is afforded protection under the VDP, as long as the ultimate disclosure results in the VDP criteria being met.

If the intention of paragraph 40 is to remove the protection of the taxpayer from the date of filing the no-name application, then we believe this is a regressive step that will deter many taxpayers from using the VDP – particularly taxpayers who are uncertain of the track that will apply to them. In our experience, taxpayers find the no-name process and the protection it affords helpful because it further reduces the uncertainty of the treatment they will be accorded. We do not believe there is any benefit of removing protection from the EDD in a no-name voluntary disclosure.

The three track system still requires a no name procedure protected by the EDD to allow the applicant and VDP officers to have constructive discussions on the appropriate track and unique circumstances of the taxpayer that could favour a flexible application of the tracks (e.g., in the rogue employee example described in Part C above).

Further, as advisors, we often use the no-name disclosure to encourage clients to come forward and complete a voluntary disclosure. Clients are much more comfortable doing a no-name disclosure first. Then, as the 30-day period comes to an end and clients have some certainty on how the disclosure will be handled, we encourage them to complete the disclosure on a named basis. Without this deadline, it is often difficult to get the client to focus on the issue, and delays will likely result in fewer disclosures, especially as limitation periods start getting closer.

We recommend that paragraph 41 of the Draft Memorandum be clarified to state that the taxpayer is granted protection on the amounts included in the disclosure from the EDD, provided the disclosure meets the five validity conditions within a specified time period (e.g., 90 days).

F. Clarifications on Second VDP Application by Same Registrant

Paragraph 37 of the Draft Memorandum provides that a second application for voluntary disclosure will normally only be considered if the circumstances surrounding the second application are both beyond the registrant's control **and** related to a different matter than the first application.

The requirement that a taxpayer meet both criteria is onerous and contrary to the purposes of the VDP. If the circumstances are beyond the registrant's control, a second application of the same issue should be accepted. If the disclosure relates to a different matter than the first application, the second application should also be accepted.

We recommend that paragraph 37 be revised to state that a second application for voluntary disclosure will normally only be considered if the circumstances surrounding the second application are either beyond the registrant's control **or** related to a different matter than the first application.

G. Names of Advisors

We believe the requirement in paragraph 27 of the Draft Memorandum to include the name of an advisor in a VDP application should be revised.

In most GST/HST cases, the role of an advisor will not be relevant. For example, if an advisor advises a client that a certain kind of product should be zero-rated, and the client later determines that the product is more likely taxable and GST/HST should have been collected, the name of the advisor should not be relevant.

We suggest that paragraph 27 be revised to require the name of an advisor only in cases where misconduct by an advisor is alleged or suspected.

Thank you for the opportunity to provide our comments on the Draft Memorandum. We would be pleased to meet with you to discuss any of the issues raised.

Yours truly,

(original letter signed by Marc-André O'Rourke for Alan Kenigsberg)

Alan Kenigsberg
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