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Via email: Kevin.Morgan@cra-arc.gc.ca

Kevin Morgan
Manager
Voluntary Disclosures Program
Horizontal Integration Directorate
Assessment, Benefit and Services Branch
Canada Revenue Agency
750 Heron Road
Ottawa, ON K1A 0L5

Dear Mr. Morgan:

Re: Voluntary Disclosures Program – GST/HST Issues

I am writing on behalf of the Canadian Bar Association's Commodity Tax, Customs and Trade Law Section (CBA Section), and the Section's Voluntary Disclosures Program Committee, to comment on GST/HST voluntary disclosures, including suggestions for improving the Canada Revenue Agency's voluntary disclosures program (VDP).

The CBA is a national association of approximately 36,000 lawyers, Québec notaries, students and law teachers, with a mandate to promote improvements in the law and the administration of justice. The CBA Section comprises lawyers from across Canada who deal with law and practice issues relating to commodity tax, customs and trade remedy matters.

Unique Context of GST/HST Regime

The unique context of the GST/HST regime underlies our issues and suggested recommendations. The regime is structured to make the supplier responsible, as agent of the Crown, for properly charging, collecting and remitting the GST/HST. In our experience, the CRA usually audits the supplier for failing to collect the GST/HST, rather than the taxpayer for failing to pay. Accordingly, the VDP is used almost exclusively by suppliers to correct errors in charging, collecting or remitting the GST/HST.

Suppliers perform an important role in collecting and remitting the GST/HST, as agents of the Crown. The CRA should be sensitive to ensure that suppliers have every incentive to come forward and use the VDP to correct past errors in collecting and remitting GST/HST and that the VDP process is efficient, coordinated and provides certainty of outcome.

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Unlimited Lookback Period Undermines Viability of the GST/HST VDP

The main purpose of the VDP is to encourage taxpayers to voluntarily disclose and correct past errors. This purpose is being undermined in the GST/HST context by requiring suppliers to provide details of the GST/HST liability at issue back to the first instance of the error to satisfy the "completeness" requirement, even if the first instance of the error occurred back to 1991 (when the GST was first imposed).

Where the error is longstanding (i.e., goes back more than four years) and does not involve misrepresentation due to neglect, carelessness or wilful default or fraud, a supplier's potential GST/HST liability is often greater if the supplier voluntarily discloses the error than if the supplier left the past as is and risked a normal GST/HST audit. As legal advisors, it is difficult explaining to clients that they could be worse off if they do the right thing by voluntarily coming forward, particularly since they are saving the CRA the expense of a normal audit.

The unlimited lookback period leads to many GST/HST voluntary disclosures being filed on a "no-names" basis for one purpose only: to negotiate the appropriate lookback period so the client can make an informed decision on whether to finalize the voluntary disclosure or take a chance on audit. These additional filings and consultations with voluntary disclosure officers involve additional legal fees for clients, waste valuable CRA resources and only serve to complicate and lengthen the VDP process, which is not in anyone's interest.

The statutory requirement to retain books and records for GST/HST purposes is only six years. So, in some cases, a GST/HST advisor can try to negotiate with the voluntary disclosure officer to limit disclosure to six years (on the basis that good records do not exist for prior periods), but even where a six year lookback is accepted, it is not clear whether the CRA might try to audit prior periods that were not disclosed.

In practice, the unlimited lookback period means a supplier that makes a voluntary disclosure must go back and invoice its previous customers for GST/HST, possibly back six years or even further. Suppliers must convince these customers who are involved in commercial activity that they can claim input tax credits on the basis of a "tax-only" invoice. Customers often balk at making the payments, and indeed, many suppliers are loath to invoice their customers for these amounts, for fear of harming the customer relationship.

The CBA Section recommends:

- Where the supplier failed to collect the appropriate amount of GST/HST, the CRA should set a limit to the lookback period for which a supplier can be assessed. Our recommendation is a four-year lookback period, to match the audit period in the *Excise Tax Act* (ETA). It is unfair to expect suppliers to voluntarily disclose a failure to collect GST/HST when they are not provided with terms at least as favourable as they could expect from an audit.
- For GST/HST that was collected by a supplier and not remitted, we agree that there should be no set limit to the lookback period and the disclosure should be complete. It is unfair for a supplier to be enriched at the expense of the government.
- The VDP policy should be clear that once the appropriate lookback period is determined by the voluntary disclosure officer, the CRA will not audit and assess GST/HST for previous years on any issue that was disclosed.

GST/HST Relief Should be Provided for in Wash Transactions

The CRA has recognized that the GST/HST system gives rise to "wash transactions": if the supplier had properly charged the appropriate amount of GST/HST, the recipient (taxpayer) would have received a full refund of the taxes by way of input tax credit. In other words, the result is no loss of revenue to the government. The CRA's administrative 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.

Given that wash transactions involve no loss of revenue to the government, 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 the GST/HST from its customers. Again, customers often push back at making payments when issued a "tax-only" invoice. Many suppliers forego invoicing customers for these amounts for fear of harming the customer relationship.

The CBA Section recommends:

- GST/HST should not be assessed against the supplier in wash transactions. 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.

Processing Notices of Assessment for GST/HST Liability and Net Tax Refunds Should be Better Coordinated for Voluntary Disclosures Involving Related Persons

Voluntary disclosures often involve GST/HST that a supplier failed to charge and collect from an affiliate in a closely related group in which all parties are exclusively involved in commercial activity. Consequently, there is no loss of revenue to the government. However, the CRA's current process of dealing with GST/HST payable by one entity separately from the refund owing to the related entity causes cash flow problems for the corporate group as a whole.

In our experience, the CRA issues Notices of Assessment to suppliers (requiring payment of GST/HST liability in full) more quickly than it processes the corresponding net tax refunds for the recipients in the group.

For example, if ACo should have collected $1M of GST/HST from a related party BCo, and both ACo and BCo make a joint voluntary disclosure explaining the situation, the CRA will accept the $1M of GST/HST immediately under the VDP, but will not process BCo's input tax credit claim for $1M under the VDP. Rather, the input tax credit claim is sent to a different division of the CRA for normal processing, where it may be held up for an audit.

The CBA Section recommends:

- If the CRA does not agree that full GST/HST relief should be provided for in wash transactions (as per our recommendation above), to minimize cash flow costs to suppliers, the CRA should better coordinate processing of Notices of Assessment for GST/HST liability and net tax refunds for voluntary disclosures involving corporate affiliates.

Penalty Relief Should Apply to Additional Amounts Assessed for Period Covered by Voluntary Disclosure

The GST/HST system relies on precise technical rules on which supplies of property and services are subject to GST/HST. When a person makes a voluntary disclosure, a nuanced issue often caused the error. We understand that since the VDP was centralized at its current locations, voluntary disclosure officers do not have technical expertise in GST/HST matters.

In practice, many voluntary disclosures that we file on behalf of clients require us to take a position on the taxable or non-taxable status of certain supplies, based on our best interpretation of the legislation and CRA administrative policy. Our understanding is that the voluntary disclosure officers do not have the expertise to fully evaluate these positions, and the disclosed transactions and positions are potentially subject to future audit.

If the auditors do not agree with the positions on the disclosed transactions, the person could be assessed for additional amounts, plus penalties and interest, that were not paid under the VDP due to an interpretive position that was included as part of the voluntary disclosure. This seems like the obvious conclusion, but we are not aware of a clear CRA statement to this effect.

The CBA Section recommends:

- Confirm that a person who makes a voluntary disclosure is entitled to the benefit of relief under the VDP for any additional amounts assessed by the CRA for the period and issues covered by the voluntary disclosure.

GST/HST Refund Returns Should Be Considered Under the VDP In Appropriate Circumstances

It is unclear from Information Circular IC00-1R4, Voluntary Disclosures Program (the Information Circular) which GST/HST returns will be accepted or rejected by the VDP. Often, a voluntary disclosure must be filed by a person who has not properly filed monthly GST/HST returns for several years.

According to paragraph 19 of the Information Circular, "income tax returns with no taxes owing, or with refunds owing," would not be considered under the VDP. The paragraph does not mention GST/HST returns. For GST/HST returns, a supplier might report taxes owing in one month, and a refund in another month. The GST/HST returns must all be filed under the VDP to fulfil the completeness requirement.

We have learned that the CRA removed GST/HST refund returns from a voluntary disclosure, based on paragraph 19 of the Information Circular, and sent them to the CRA's normal audit processes. This causes confusion for the person making the disclosure. The person making the disclosure is not always told how the GST/HST refund returns are being treated by the CRA. In one instance, the practical result was that the refunds included in the calculation by the person were disregarded, so the payment under the VDP was considered by the CRA to be insufficient, which led to additional, unexpected interest charges. The refund returns were then audited, which led to a full-scale GST/HST audit.

The CBA Section recommends:

- Given the nature of the GST/HST and the fact that GST/HST reporting follows transaction flows, refund returns should be considered together with the returns

showing remittances in evaluating a voluntary disclosure. Specifically, the complete disclosure should be considered on a global basis (including returns that show only refunds) to avoid the process distortion as described.

- If any filings made under the VDP will be sent for review and processing outside the protections of the VDP, the voluntary disclosure officers should inform a person of their decision, and give the person an opportunity to respond to the concerns of the voluntary disclosure officer.

Need for More Transparency

The form letters sent by the VDP to persons making a voluntary disclosure do not provide useful contact information for the decision-makers. Rather, the letters name the Team Leader and direct the person to contact the CRA's call centre with any questions. In many cases, a person will want to follow up directly with the voluntary disclosure officer or team leader, for example, on the application of interest relief. It would be helpful if the CRA VDP provided more specific contact information for that purpose.

The CBA Section recommends:

- The voluntary disclosure officers and team leaders should be in direct contact with the person making the disclosure and should provide follow up contact information.

Thank you for your attention to these issues. We look forward to your feedback and would be pleased to meet with you to discuss any of the above.

Yours truly,

(original letter signed by Gillian Carter for Maurice J. Arsenault)

Maurice J. Arsenault
Chair, CBA Commodity Tax, Customs and Trade Section