



AUGUST 2010

Coming Clean with the CRA – the Voluntary Disclosure Program

WHILE IT'S OBVIOUSLY PREFERABLE, WHEN IT COMES TO taxes, to file on time and to make sure the information provided to the CRA is complete and accurate (as each taxpayer certifies on the last page of his or her return), things don't always happen that way. Taxpayers who are in financial difficulty and unable to pay their taxes may simply put off filing. More commonly, a taxpayer may discover, after filing a return for the year (or previous years), that an information slip was overlooked and a portion of income consequently not reported. Or, the taxpayer may receive an amended T4 after filing his or her return, necessitating a change in the return filed and, sometimes, an increase in tax payable. The dilemma which arises, of course, is whether to come clean with the tax authorities, or "lie low" and hope the failure to file or error or omission is never discovered.

Where the needed change is in respect of a current year return, it's relatively simple to set things right. In such circumstances, the taxpayer needs to write to the Tax Centre to which the original return was sent, notifying them of the error and providing the correct information. It is not necessary, in fact not advisable, to send a second return containing the correct information to the CRA. Doing so is more likely to create confusion than to resolve matters. Rather, in such circumstances, the CRA provides a form to be used — the T1-ADJ. While the use of the form, which is available on the Agency's Web site at <http://www.cra-arc.gc.ca/E/pbg/tf/t1-adj/t1-adj-10e.pdf>, isn't mandatory, using it does ensure that all the information required by the CRA to process the taxpayer's request has

been provided. Once the T1-ADJ is received, the corrected information should be incorporated into the taxpayer's return and reflected on the Notice of Assessment ultimately issued by the CRA.

Where a failure to report income, or to file, or the erroneous claiming of a deduction or credit which is discovered by the taxpayer relates to a previous taxation year, the CRA provides taxpayers with another option, in the form of the Agency's Voluntary Disclosure Program ("VDP"). As the name implies, the Program allows taxpayers to voluntarily disclose to the CRA any past errors or omissions or failures to file when required. Where the requirements of the program are met, the CRA is authorized to cancel (or "waive") any penalties which might otherwise be assessed against the taxpayer. It's important to note that only penalties may be forgiven, and that the taxpayer will, notwithstanding any voluntary disclosure, continue to be "on the hook" for any outstanding taxes, plus interest charges.

The CRA imposes four conditions which must be met before a disclosure will qualify under the program. They are as follows.

- The disclosure must be truly voluntary in nature – that is, it must be initiated by the taxpayer and, in particular, must not be the result of the taxpayer's knowledge of enforcement action about to be taken by the CRA. In other words, a taxpayer who "voluntarily" discloses past transgressions after finding out that he or she is about to be audited will not qualify under the program.

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- Any disclosure made by the taxpayer must be “complete”, as that term is understood by the CRA. The taxpayer is expected to provide full and accurate reporting of all previously inaccurate, incomplete, or unreported information. It’s not possible to make selective disclosure of, for instance, one tax year but not others. As well, the CRA will request documentation to verify the amounts to be disclosed. If that documentation shows that the initial disclosure contained significant errors or omissions, the disclosure will not qualify under the VDP. In such a case, the disclosed information will be processed by the CRA and the Agency will be able to apply interest and penalties to the entire outstanding amount.
- The voluntary disclosure by the taxpayer must involve at least one penalty. Since the point of the VDP is to forgive penalties while collecting outstanding taxes and interest, there would be no point to seeking penalty relief where no penalties are involved. In such cases, the relevant information should simply be disclosed to the CRA, which will process it and assess any taxes and interest owed.
- Finally, the taxpayer’s disclosure must generally include information which is at least one year past due. In other words, a disclosure could not normally be made in respect of a 2008 income tax return (which was due April 30, 2009) until May of 2010. The CRA will, in some circumstances, accept a disclosure of information which is less than one year past due, but such disclosure cannot be used by the taxpayer simply to avoid penalties. For instance, a taxpayer who fails to get his return in and his taxes paid by April 30 cannot make a “voluntary disclosure” a few days or weeks later simply in order to avoid the late-filing penalty which would otherwise be assessed.

Finally, a taxpayer who is considering making a voluntary disclosure (and whose situation meets the four criteria required by the CRA, as outlined above) can “test the waters”, to a degree, before deciding to make full disclosure. The CRA will accept a “no-name” disclosure from a taxpayer and will discuss the taxpayer’s situation with him or her on a hypothetical basis, providing the taxpayer with information on how an actual disclosure would be handled. The CRA’s policy with respect to such no-name disclosures requires the taxpayer who makes a no-name disclosure to provide identifying information within 90 calendar days from the effective date of disclosure. During the 90-day period, the taxpayer is protected from prosecution and from the application of penalties. However if, at the end of the 90-day period the identity of the taxpayer remains unknown, the voluntary disclosure file will be closed without further contact from the CRA, and no extension of the 90-day period will be allowed to identify the taxpayer.

No one really likes paying taxes, and paying back taxes, plus interest, is even more unpalatable. However, for taxpayers who find themselves in a position where an investigation or audit by the CRA into their affairs would likely result in the payment of taxes, plus interest, plus penalties, or even a prosecution, the Voluntary Disclosure Program offers a way to “come clean” without the risk or prosecution, and without the often onerous penalties which can be levied by the tax authorities.

The information presented is only of a general nature, may omit many details and special rules, is current only as of its published date, and accordingly cannot be regarded as legal or tax advice. Please contact our office for more information on this subject and how it pertains to your specific tax or financial situation.