

Jan. 18, 2011

**HOUSE OF COMMONS  
FINANCE COMMITTEE  
ON OFFSHORE BANKING**

**DAVID H. SOHMER**

A - Introduction

In a December 2010 speech, IRS Commissioner Doug Shulman stated:

“During my tenure as Commissioner, I have made cracking down on offshore tax abuse a major priority. I believe our approach follows a natural course ... cleaning up the abuses of the past and then mining and leveraging the data we receive to mount a greater attack on the abuse. A perfect example is our Voluntary Disclosure Program and our work on UBS.

We had approximately 15,000 voluntary disclosures from individuals who came in before the special VDP program ended last year. And since the special program closed, we have received an additional 3,000 voluntary disclosures from individuals with bank accounts from around the world.

Collecting additional revenue for past misdeeds – as important as that may be – is not the only important consideration here. It is equally important that we are bringing 18,000 U.S. tax payers, and counting, back into the system ... back into compliance ... so they properly report and pay their taxes for years to come.

....

Given its success, we are seriously considering another special offshore Voluntary Disclosure program.”

Canada’s voluntary disclosure program (“VDP”) has been far less successful than its American counter-part in achieving the objectives described by Commissioner Shulman. In order to determine how Canada’s VDP can be more successful, this paper will review the program from three perspectives: which Canadians are disclosing, why they are disclosing, and why more are not disclosing.

B - Which Canadians Are Disclosing

Spiegel Sohmer Inc. has one of the most active VDP practices in Quebec. The demographics of its current VDP clientele are as follows:

Average age	72
Median age	75
Average amount offshore	\$3.7 million
Median amount offshore	\$1.2 million
% male	57%
% female	43%
%immigrants	51%
% offshore accounts inherited	41%

The foregoing was derived from an analysis of 51 clients who have engaged Spiegel Sohmer with respect to the VDP in 2009 and 2010. It excludes many potential clients who have indicated that they will only decide whether or not to engage us after the policy of the Ministère du Revenu du Québec is clarified. The demographics of the potential clients appear to be consistent with those of current clients. Particular note should be taken of the fact that none of the current clients have transferred funds to offshore accounts in the last ten years.

According to the Canadian Press, an October 2005 draft CRA review of the VDP indicates that in 2003-2004, the main clients were men whose average age was 49. The baby-boom generation was born between 1946 and 1964 so that their average age in 2003-2004 was 49.

This supports our experience that there has been a dramatic shift in the demographics of clients availing themselves of the VDP from baby-boomers to the parents of baby-boomers. It also supports our observation that the VDP does not encourage non-compliance. Young and middle-age non-compliant taxpayers are typically recidivists and will not reveal their *modus operandi* to the tax authorities. Furthermore, the prospect of disclosing in their seventies or eighties is too remote to influence their behavior. I have been practicing tax law since the inception of the VDP and I have never heard of anyone who transferred funds offshore in contemplation of a voluntary disclosure.

C - Why Canadians Are Disclosing

The increased number of disclosures has had little to do with the CRA cracking down. The increase is primarily due to the following:

- 1) The Canadian Securities Administrators announced changes to the registration requirements for all investment dealer and adviser firms doing

business in Canada effective as of September 28, 2009. National Instrument 31-103 provides that international dealers and international advisers can rely on an exemption provided that they only act for a "permitted client" which is defined to mean, *inter alia*, "an individual who beneficially owns financial assets ... having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds \$5 million;". All banks relying on the exemption are required to contact their Canadian clients to determine whether they qualify as permitted clients. UBS AG and Credit Suisse (and, I have been advised, other banks including Julius Bär), did so and requested them to certify that they were permitted clients. Failure to provide the certificate meant that the banks would no longer act as broker or adviser. The receipt of the letter was disconcerting, particularly to the elderly.

- 2) As a result of a highly publicized attack by the IRS on UBS AG, a deferred prosecution agreement was entered into which provided for the disclosure by the bank of the identities of 4,450 Americans who had accounts with it.
- 3) Elderly taxpayers desire to put their affairs in order before they die. Offshore accounts can be a source of friction for heirs.
- 4) In 2006, an employee of LGT Treuhand, a Liechtenstein bank, provided the German tax authorities with the names of more than 1,400 clients with accounts. Germany provided Canada with information that 106 Canadian residents had approximately \$100 million in accounts with the bank.
- 5) French tax authorities were given records of HSBC bank accounts which had been stolen by a former employee of the bank. France provided Canada with details on about 1,800 accounts held by Canadians.

D - Why More Canadians Are Not Disclosing

A successful VDP must meet the following criteria:

- 1) It must provide for a predictable set of outcomes.
  - 2) It must find a balance between what taxpayers are willing to pay and what should be paid to be fair to compliant taxpayers.
  - 3) It must be based on a sound legislative foundation.
- a) It must provide for a predictable set of outcomes

The most important factor in determining the quantum of tax, interest and penalties which will have to be paid pursuant to a disclosure is the number of

years or periods that are included in the disclosure. Subsection 220(3.1) of the Income Tax Act ("ITA") only permits the Minister to waive all or a portion of penalties and interest for the ten-year period preceding the year in which relief is requested. If years prior to the ten-year period are included, the tax, penalties and interest, may well exceed the amount currently in the offshore account. The Voluntary Disclosure Program Guidelines dated June 2008 provide VDP officers with the following guidelines.

**"3.3.5 – Number of Years or Periods to Assess within the Disclosure**

**3.3.5.1 – General**

The number of years or periods, except non-statute-barred years or periods, to assess within a complete disclosure should be determined from the facts and circumstances of the particular case. The taxpayer or representative should understand that all of the facts and circumstances of the omission must be provided in order for the VDP officer to make a reasoned judgment. These comments are intended to guide VDP officers in making that determination.

....

The VDP officer should be satisfied that the taxpayer has made their (sic) best effort to obtain supporting documentation and assemble any required financial information. If the taxpayer would incur significant costs to determine the amount of the omission, the circumstances should be brought forward and discussed with the VDP officer. The VDP officer could also consider whether the CRA would expend its resources to identify the omission.

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**3.3.5.4 – Multiple years or periods**

When omissions occur in any of the most current 6 years due, the VDP officer should assess these years within the disclosures.

When there are omissions in years prior to the above, the VDP officer should consider the following factors in determining whether these additional years should be assessed or adjusted:

- \* Whether a significant portion of the omission relates to these prior years.

- \* The taxpayer's compliance history.
- \* The duration of the non-compliance.
- \* The complexity of the non-compliance.
- \* The taxpayer's knowledge and expertise."

In her 2004 November Report, the Auditor General stated that there were significant inconsistencies in the way these guidelines were followed across the country and recommended that the CRA "implement its February 2004 action plan, with particular emphasis on aspects designed to ensure that the program is administered consistently across the country". The CRA responded that it agreed with her recommendation and that it has started implementing the February 2004 action plan that will address consistency issues. In a June 2010 speech to the Society of Trust & Estate Practitioners, a CRA official said that clarification of VDP procedures and policies would be issued in the coming weeks with the objective of having "a process that will be consistent across the country, so whether you make a disclosure in St. John's, New Brunswick or Vancouver, you get equal and fair treatment". Notwithstanding the foregoing, the CRA stated at the October 2010 Annual Conference of the Association de planification fiscale et financière that there would be no change in procedure and policy and that income would be taxed for all years for which there are business records. At the November 2010 Annual Tax Conference of the Canadian Tax Foundation, the CRA stated at its Roundtable:

"There is no new policy relating to disclosures in respect of offshore assets.

....

How far back the CRA may go in terms of the number of years reviewed and assessed is determined by the facts presented in each case."

While the current practice of the CRA is to include only ten years of income related to offshore accounts, the guidelines require that "the VDP officer should be satisfied that the taxpayer has made their (sic) best effort to obtain supporting documentation and assemble any required information." Though Swiss law requires banks to retain books and records for a period of ten years (Article 962 of the Swiss Code of Obligations), it is obvious that information for many prior years continues to be stored in computers and archives. In the light of the foregoing, it is not surprising that some VDP officers have interpreted the statements by the CRA as requiring the taxpayer to satisfy them that best efforts have been made to obtain more than 10 years of records. This raises consistency and predictability issues which will deter taxpayers from disclosing.

Of particular concern is the fact that the CRA and the Ministry of Revenue of Quebec ("MRQ") have not attempted to harmonize their positions. The MRQ has indicated that it will not abandon its approach pursuant to which capital at the beginning of the sixth year will be treated as if it was earned in the fourth year. The fact that there is no statutory authority for taxing income in one year where that income was earned in a different year is not regarded as an obstacle by the MRQ. The position of the MRQ will be challenged by way of both administrative appeals and litigation and we do not anticipate a resolution for several years. The process will undermine the federal VDP. Because the CRA and MRQ exchange information, Quebec-resident taxpayers may decide not to disclose to either. Furthermore, even though Quebec's position may be illegal and counter-productive, electoral politics may result in accusations that the CRA is soft on tax evaders.

The protocol amending the Canada-Switzerland Tax Convention signed on October 22<sup>nd</sup>, 2010 requires a requesting state to provide the name of the taxpayer and the name of any person believed to be in possession of the requested information. It specifically prohibits "fishing expeditions" and provides that there is no obligation to exchange information on an automatic or spontaneous basis. Our experience indicates that most offshore accounts have not had deposits or withdrawals for over a decade so Canada is unlikely to know the identities of the taxpayers or the banks. Furthermore, if offshore funds are bequeathed to children who have emigrated, the "revenue rule" will deny Canada access to foreign courts to collect tax due by their parents. The "revenue rule" is a well-recognized rule that the authorities of one state will not assist in the recovery of taxes due to another state. It is unlikely that many parents of baby-boomers will be alive when (and if) effective mutual assistance in the collection of tax becomes the norm in international tax law. It is even more unlikely that such assistance will extend to collecting tax payable to a political subdivision.

The failure of the VDP to provide for a predictable set of outcomes coupled with a minimal risk of detection, encourages non-compliant taxpayers to avoid availing themselves of the VDP.

- b) It must find a balance between what taxpayers are willing to pay and what should be paid to be fair to compliant taxpayers

We have calculated that the special VDP referred to by Commissioner Shulman resulted in U.S. federal tax, interest and penalties equal to approximately 31% of the current account balance. Where the taxpayer was a resident of New York State, the result would be increased by approximately 1%. Our calculations indicate that the current practice of the CRA results in federal tax and interest of approximately 15% of the current account balance. Provincial tax and interest payable by residents of provinces other than Quebec would be approximately 15% as well, for aggregate tax and interest of approximately 30%. Our calculations indicate that provincial taxes and interest payable by residents of Quebec would be approximately 28% of the current

account balance so that aggregate federal and Quebec tax and interest would be approximately 43%.<sup>1</sup> The actual rates may vary, in some cases substantially. Where, for example the value of a stock portfolio has decreased, the opening capital may be significant in relation to the current balance. Our experience indicates that the amounts payable in accordance with the current federal practice is acceptable to most non-compliant taxpayers other than those resident in Quebec. This is consistent with the American experience. If the MRQ does not harmonize with the CRA, we expect that many non-compliant Quebec residents will consider other options.

It is of more than passing interest that until December 31, 2008, Quebec-resident taxpayers typically settled disclosures for tax and interest of approximately 19% payable to each of the CRA and the MRQ, i.e. an aggregate of approximately 38%. The CRA unilaterally and without explanation changed its VDP policy effective January 1, 2009. VDP officers with the CRA insisted that opening capital in the tenth year prior to the year of disclosure be taxed as income earned in that year, so that tax and interest payable to the CRA increased to approximately 30%. The MRQ immediately followed suit. The number of clients who were willing to initiate no-name disclosures decreased dramatically. The exceptions were those who had inherited the accounts from non-residents or who held primarily stocks at the commencement of the tenth year, in which case both the CRA and MRQ were willing to include only 50% of the cost of the stocks in income. In June of 2010, leaks from the CRA indicated that pursuant to a review of its VDP policy, it would only tax income actually earned in the ten year period preceding the year of disclosure, which reduced tax and interest payable to the CRA to approximately 15%. In anticipation of the MRQ following suit, the pace of disclosures increased. Once Quebec indicated that it would not follow suit, the number of disclosures decreased dramatically again.

c) It must be based on a sound legislative foundation

Subsection 152(4) ITA provides that the Minister may at any time make a reassessment if the taxpayer has made any misrepresentation that is attributable to neglect, carelessness or willful default or has committed any fraud in filing a return. This provides the Minister with the legislative authority to tax only years with respect to which subsection 220(3.1) permits the Minister to waive all or a portion of penalties and interest. The 1991 Technical Notes with respect to subsection 220(3.1) indicate that the legislative purpose was to grant relief to taxpayers in cases of "extraordinary circumstances beyond their control ...". Failing to report income relating to an offshore account is rarely attributable to extraordinary circumstances beyond the taxpayer's control. However, it would be consistent with current jurisprudence relating to statutory interpretation for the Minister to ignore the Technical Notes, so that as long as procedural fairness is exercised, the Minister would be authorized to grant relief as part

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<sup>1</sup> The calculation of amounts payable under the American special VDP are based on the example contained in IRS "Voluntary Disclosure: Questions and Answers" posted May 6, 2009, (Q and A12). The calculations of amounts payable federally and to Quebec are based on a hypothetical \$U.S. 1 million transferred offshore at the end of 1999 and invested in a debt instrument yielding 5% p.a..

of the VDP. The CRA's current practice of including only ten years of income is accordingly legally sound.

E - Conclusion

The Canadian parents of the baby boom generation have accumulated substantial wealth so that it is not surprising that they constitute a significant proportion of non-compliant taxpayers. There is no doubt that recent events have increased the price that they are willing to pay to put their affairs in order. The price however must be predictable and not perceived by them to be confiscatory. The American special VDP used an iron fist together with a velvet glove. Canada is a small country and must rely on international cooperation to provide it with a credible iron fist, a prospect which is still some years away. If a VDP does not encourage non-compliance and if a VDP will encourage elderly tax evaders to repatriate tens of billions of dollars, Canadian tax policy should not undermine the program because of the absence of a credible deterrent.

Both the CRA and the MRQ would be well advised to take particular note of the following statement by Keith Ashfield, the Minister of National Revenue:

"In fact, because more and more people are coming forward to declare their offshore assets, we are recovering far more in tax revenue than if the CRA went looking for this money. Rather than reviewing piles of documents, chasing anonymous leads and spending weeks in court proceedings; Canadian taxpayers are now coming to the CRA directly to clear their conscience...they are coming forward to declare their assets in numbers never seen before." (National Post, October 9, 2010)



## SOHMER TESTIMONY AT COMMONS FINANCE COMMITTEE

*Editor's Note: David Sohmer, a regular contributor to these pages, appeared before the Commons Finance Committee on February 8 along with an American colleague, Scott Michel of Caplin & Drysdale as part of the committee's hearings on offshore banking. The following are Sohmer's notes which he has allowed us to publish. A transcript of the full testimony and questions can be found at the Committee's Web site.<sup>1</sup>*

"Sound tax policy should be based on facts and not on fantasy or fiction, and my presentation attempts to provide the Committee with the facts from the perspective of a tax lawyer who has been involved with the voluntary disclosure program since its inception. The following are some of the more important facts contained in my brief:

- 1) There has been a dramatic shift in the demographics of Canadians who availed themselves of the voluntary disclosure program in the last five years from baby boomers to the parents of baby boomers. In 2003-2004, the main clients

<sup>1</sup> <http://www2.parl.gc.ca/committeebusiness/CommitteeMeetings.aspx?Cmte=FINA&Language=E&Mode=1&Parl=40&Ses=3>.

were 49 year old males. Based on an analysis of 51 clients who have engaged me in 2009 and 2010, the average age is 72 and the median age is 75. 57% are male and 43% are female, and most of the females are widows who have inherited the accounts.

- 2) The increased number of disclosures has had little to do with CRA enforcement activities. The increase is almost exclusively due to events which, by happenstance, occurred in the same time frame. The first was the change in registration requirements for investment dealers and advisers by the Canadian Securities Administrators. The change was effective as of September 28, 2009 and provided an exemption for foreign banks whose Canadian clients were restricted to those with net financial assets of more than \$5 million. UBS and Credit Suisse, as well as other foreign banks, contacted their Canadian clients and requested written certification that the clients met the threshold, failing which they would no longer provide dealer and advisory services. The second was the aging of the parents of baby boomers. They have accumulated substantial wealth, and the older they get, the greater their desire to put their affairs in order before they die. The third was the highly publicized deferred prosecution of UBS by the American Internal Revenue Service. The fourth was the theft of data from LGT Treuhand, a Liechtenstein bank and from HSBC. The data contained the names of Canadians who held accounts with the banks.
- 3) The era of banking secrecy is not over. Article 26 of the OECD Model Tax Treaty is the international standard and is reflected in the protocol to the Canada-Suisse tax treaty signed on October 22, 2010. Canada must provide the Swiss with the name of the taxpayer and the name of the bank. Fishing expeditions are expressly prohibited. Most golden-agers have not deposited or withdrawn funds for over a decade, so Canada is unlikely to know their identity and the risk of detection is minimal.
- 4) The Voluntary Disclosure Program is being undermined by CRA policy and by the refusal of Quebec to harmonize its program with that

of the CRA. The current CRA practice provides for a predictable set of acceptable outcomes, a critical aspect of successful voluntary disclosure programs. The CRA however, does not preach what it practices. Its official policy gives VDP officers substantial discretion in determining which years should be included in a disclosure. This raises consistency and predictability issues which will deter taxpayers from disclosing.

The most serious threat to the program is the refusal of Quebec to harmonize its program with that of the CRA. The Ministry of Revenue of Quebec insists on taxing the balance which was in the account six years ago as income earned in that year. There is no legislative authority for doing so and unlike the CRA policy, Quebec refuses to allow its decision to be attacked by way of administrative appeals or appeals to the courts, even where there is a lack of due process or where the decision is clearly wrong on its merits. Quebec's policy is also counter productive. In one file we are dealing with, the amount payable to the CRA is \$169k and to the MRQ is \$1,034k. In another, the amount payable to the CRA is \$44k and to the MRQ is \$224k.

Pursuant to an agreement between the CRA and the MRQ, the CRA provides the MRQ with information relating to disclosures made to it so a disclosure to the CRA is effectively a disclosure to the MRQ. Since there is little risk of detection, at least in the next 5 to 10 years, it is expected that many Quebec residents whose children reside out of the province will not disclose. Their children will probably disclose to the CRA after they inherit the accounts. The "revenue rule" is a well recognized rule that the authorities of one state will not assist in the recovery of taxes due to another state. It is clear that the U.S. will not assist in the recovery of Quebec tax, and it appears that other provinces will not do so either. It is also arguable that the U.S. will not assist in the recovery of federal tax where the liability of U.S. resident children arises under Canadian law because of an inheritance.

It is estimated that Canadians have \$100 billion in offshore accounts. The stars are aligned now as they have never been and as they may never be again. There is a window of opportunity for Canada and

the provinces to have tens of billions of dollars repatriated and to realize a significant increase in short-term tax revenue. The voluntary disclosure program does not encourage non-compliance. Golden-agers have not transferred funds offshore for decades and younger tax evaders are recidivists who do not evade in contemplation of disclosing. The U.S. and the U.K. have recognized the merits of a pragmatic approach. The American settlement initiative has been described by my fellow witness Scott Michel, a recognized authority on the U.S. voluntary disclosure program, as ranking "in the upper tier of compliance successes ever implemented". For bureaucratic paranoia, Quebec-Ottawa friction and electoral politics to impede a successful voluntary disclosure program is not in the national interest nor is it in Quebec's interest."

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# Latest leak may sink some Canadians

By DONALEE MOULTON

Former Swiss banker Rudolph Elmer's much-publicized release of confidential offshore account information could have reverberations in Canada, financial experts warn.

"If you are a Canadian and have an account in an offshore bank, and presumably not reporting this to CRA for tax purposes, you have to start sweating," said Karim Jamal, an accounting professor at the University of Alberta's School of Business in Edmonton. "This could have some unpleasant tax implications including paying back taxes, interest and penalties — and possibly going to jail."

Elmer, chief operating officer for the Swiss private bank Julius Baer Bank in the Cayman Islands until he was dismissed in 2002, handed over roughly 2,000 files to WikiLeaks founder Julian Assange, who has said he will post them on his whistleblowing website once their authenticity is confirmed.

The 55-year-old former banker has refused to provide specific information about any one or any organization contained in the files he released — including the possible inclusion of any Canadians. He has indicated, however, that the files, which span almost two decades from 1990 to 2009, will be of interest to tax authorities.

"I do think, as a banker, I have the right to stand up if something is wrong," Elmer said at a press conference held at the Frontline Club in London, England, where he alluded to unethical if not illegal offshore banking practices.

"I am against the system," he said. "I know how the system works and I know the day-to-day business. From that point of view, I wanted to let society know what I know. It is damaging our society."

He has the attention of tax agencies — and taxpayers — around the globe. "The political pressure

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*Karim Jamal, University of Alberta*

to act on this information will be tremendous," said Jamal.

"If the (Canada Revenue Agency) does not pursue these people, there will be a tremendous erosion in the faith Canadians have in the fairness of our tax system," he noted. "I don't think the CRA has any legitimate excuse to ignore this information or to not use it."

"The CRA takes all cases of suspected tax evasion seriously," said spokesperson Philippe Bideau in Ottawa.

The agency "would treat this information as any other lead or information received," he noted. "We would risk-assess the information of any Canadian appearing

lead the agency to suspect tax evasion," Bideau added, "the file would be referred to CRA's criminal investigations division for a further analysis."

It is unclear how enthusiastic the country's courts will be, however. "There is no definitive Canadian jurisprudence with respect to the use of stolen data," said David Sohmer, a tax lawyer with Spiegel Sohmer Inc., in Montreal. "Issues such as charter rights and hearsay will no doubt be argued if there is litigation, particularly since the information was given to WikiLeaks, and not to a state with which Canada has relations."

Sohmer pointed out that the

been advised that the enforcement activities have been initiated by the CRA," noted Sohmer.

In the current situation, he said, "publication by WikiLeaks is not an enforcement activity. The most prudent course would be for a taxpayer to make a voluntary disclosure."

Indeed, said Jamal, "it is better to negotiate such matters than to risk hostile publicity, fines and a possible jail sentence."

Many Canadians are stepping forward before the CRA steps in. "In the 09-10 fiscal year, the CRA received 2,964 voluntary disclosures, revealing approximately \$594.6 million in previously unre-



JAMAL

Revenue Service successfully forced UBS AG, an international bank headquartered in Switzerland, to release the names of more than 4,400 account holders living in the States.

According to a report prepared last year by the Swiss Bankers Association, Switzerland has agreed to "provide administrative assistance not only in cases of tax fraud but also in cases of tax evasion." In return, the Organization for Economic Co-operation and Development has agreed to keep Switzerland's name off a black list of countries "deemed unco-operative in tax matters," the 89-page report stated.

Meanwhile, the Elmer saga continues to unfold. The certified auditor, who has also worked at Credit Suisse and KPMG LLP, was spared a jail term after being convicted of breaching bank secrecy laws, among other charges. A Zurich judge found Elmer guilty of making a "threat, several counts of attempted duress and multiple counts of breaking banking secrecy" and fined him US\$7,500. At press time he was readying for his second court appearance on additional charges of breaking Swiss banking laws.



SOHMER

**"Publication by WikiLeaks is not an enforcement activity. The most prudent course would be for a taxpayer to make a voluntary disclosure."**

*David Sohmer, Spiegel Sohmer Inc.*

courts in France allowed that country's national tax authorities to use data stolen from a Swiss branch of the HSBC bank. As many as 24,000 customers worldwide may ultimately be affected by the release of that information.

"The policy of the CRA with respect to Canadians whose identity was disclosed in the HSBC stolen data (case) is that a disclosure will be considered voluntary as long as the taxpayer has not

ported income relating to revenues and assets located offshore," said Bideau.

Offshore accounts have become a favorite target of the CRA and enforcement efforts are unlikely to abate. "The CRA will take all appropriate steps to ensure Canada's tax laws are respected," said Bideau.

Canada is not alone in its efforts to recover lost tax revenue. Last year, for example, the U.S. Internal

on the list to determine if they have disclosed offshore assets on their foreign reporting form, or income earned through their offshore investments on their tax returns."

"Should the risk assessment

## Offshore account holders come forward

By DONALEE MOULTON

More Canadians are coming clean about money they have stashed in offshore accounts. Keith Ashfield, Canada's minister of national revenue, contends this is the direct result of a "crackdown" by the Canada Revenue Agency. Not so, say some tax experts.

"The main reason for the increase in disclosures has been the Canadian Securities Administrators' (new) regulation and the decisions by UBS and Credit Suisse that it applied to them," said David Sohmer, a tax lawyer with Spiegel Sohmer Inc. in Montreal.

The CSA's regulation, which became effective in September of 2009, created a new Canada-wide

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*David Sohmer, Spiegel Sohmer Inc.*

registration regime for all international and certain domestic investment fund managers. The new system requires firms to ensure an effective record system is in place that documents their business activities, financial affairs, and client transactions. The new regulation, called National Instrument 31-103, also includes enhanced disclosure rules. Registered firms are

expected to deliver to a client "all information that a reasonable investor would consider important about the client's relationship with the registrant." This now includes a description of the types of risks a client should consider when making an investment and the risks associated with using borrowed money to buy securities.

In the wake of this new rule,

two international financial services firms, UBS and Credit Suisse Group AG, contacted all account holders residing in Canada and requested them to certify that they were "permitted clients" as defined under 31-103. Permitted clients include banks, pension funds, financial advisors, and individuals with financial assets greater than \$5 million.

"Those account holders who

did not meet the (required) \$5-million threshold were advised to consult Canadian tax advisers with a view to availing themselves of the voluntary disclosure program," Sohmer noted in an article he prepared for *The Canadian Taxpayer* newsletter in the fall of 2010.

The tax agency won't say whether the CSA rule is pushing Canadians to come forward voluntarily. "The CRA does not speculate on issues and initiatives that fall under the responsibility of another organization," said spokesperson Philippe Bideau in Ottawa.

What is known is that the CRA is both stepping up efforts to iden-

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# Plans are no longer subject to CPP



## PAYROLL CONNECTION

By  
Steven  
Van Alstine

The third and final part of the year-end updates focuses on wage-loss replacement plan changes and legislative and regulatory amendments in Quebec for year-end 2010.

### Wage-loss replacement plans

Due to a court decision in February 2010, the Canada Revenue Agency has announced that benefit payments made to an employee under a wage-loss replacement plan are not subject to Canada Pension Plan contributions. Previously, the CRA considered such payments as pensionable if the employer paid the benefits directly to the employee, or if the employer funded any part of a third party plan and exercised a degree of control over the eligibility of benefits. The Tax Court of Canada, however, stated that disability payments were not payments for the pensionable performance of services.

The CPP/EI Rulings Division has provided the following information:

- Wage-loss replacement benefits made by a third party are not subject to CPP, even if the

employer funded and controlled the plan.

- Short- and long-term disability payments paid to employees directly by the employer are not subject to CPP.

- Fully paid sick days are not considered a wage-loss replacement plan and therefore remain subject to CPP.

- The changes are considered to be effective immediately. Employers may make requests for CPP refunds for a period of four years. The impact to employees that would be affected by such refund requests would have to be determined by Human Resources and Skills Development Canada. In other words, such refund requests could have the potential to reduce an employee's CPP benefits.

The Ministère du Revenu du Québec has not yet commented on whether they will follow the same policy for the Quebec Pension Plan.

Employers may refund employees who were over-deducted CPP in the current year. By issuing a refund, the employer would have their company portion of the CPP contributions reduced. Employers who decide to request a refund of any CPP contributions on wage-loss benefits previously considered pensionable may do so by filing a PD24 — *Application for a Refund of Overdeducted CPP Contributions or EI Premiums*: [www.cra-arc.gc.ca/E/pgb/1f/pd24/pd24-09e.pdf](http://www.cra-arc.gc.ca/E/pgb/1f/pd24/pd24-09e.pdf). The box titled "Employee was not engaged in pensionable employment" in Part

A should be ticked off and an explanation provided. A breakdown should also be provided under Part B.

Employers have no later than four years from the end of the year in which the overpayment occurred to request a CPP refund. There is no need to amend any T4 slips as the CRA will make the necessary amendments if the refund request is approved. These refunds could impact the amount of the employee's future CPP benefit entitlement.

This ruling and subsequent policy change does not affect EI, QPIP or income tax. Watch for more information on the CRA's website.

### MRQ to become an agency

On June 8, 2010, Bill 107, An Act respecting the Agence du revenu du Québec was introduced in the Quebec legislature. The purpose of this legislation is to facilitate the move of the Ministère du Revenu du Québec to agency status (Agence du Revenu du Québec/Revenu Quebec Agency).

With the creation of the agency as of April 1, 2011, the government of Quebec ensures that:

- The organization responsible for the collection of taxes and income taxes is autonomous and responsible.

- Supplementary resources are granted on a cost-effective basis that is consistent with a new approach whose foundation will be based on international best practice principles.

The modifications allow for

greater flexibility, more auditors, investigators and forensic accountants to be hired in order to enable a better collection of overdue amounts and further investment in computer information systems.

A legislative bill will be presented to the National Assembly that will define the methods to be utilized in the creation of l'Agence du Revenu du Québec.

### RL-1 form, summary changes

There are no changes to the RL-1 slip for the 2010 taxation year. The most significant change to the RL-1 Summary is the move from two to three pages. The compensation tax, which mainly impacts financial institutions, has been expanded to two lines based on changes announced earlier this year. It is anticipated that there will be more significant changes to the form for 2011 after the changes to the Commission de la santé et de la sécurité du travail (CSST) (more details below) are implemented.

### MRQ to require electronic filing

Effective Jan. 1, 2011, for the 2010 taxation year, employers who file more than 50 RL slips, by type, will be required to file their slips electronically via the Internet. This follows the CRA, which previously announced that employers who file more than 50 information returns will be required to submit their information returns electronically via the Internet.

The MRQ has also announced that it will impose the following penalties in the following years

for employers required to file electronically who fail to do so:

- \$250 for the 2011 taxation year
- \$500 for the 2012 taxation year
- \$1,000 for 2013 or subsequent taxation years

### Changes to CSST remittances

Effective Jan. 1, 2011, employers will be required to make remittances based on actual payroll rather than estimates. In addition, the CSST premiums will be remitted to the MRQ with all regular statutory deductions (previously they were remitted to the CSST). The MRQ will forward these remittances to the CSST.

Although the official remittance frequencies are the same as those used by the MRQ, the CSST will allow employers who remit, monthly, semi-monthly or weekly to remit their CSST remittances once a month on the due date that would be applicable to the due date for the last remittance for that particular month.

Employers will only be imposed penalties and interest if the employer makes their remittance to the CSST after the due date for the last remittance for the previous month.

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## Multi-pronged approach to offshore cash

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tify Canadians with undeclared offshore funds and relaxing the voluntary disclosure rules in an effort to encourage more taxpayers to come forward.

At present, said Bernard Pinsky, chair of the corporate finance and securities group with Clark Wilson LLP, a law firm in Vancouver, "if made and accepted as a voluntary disclosure by the CRA, the person will not have penalties charged on top of the interest and taxes that are due. The penalties could be as high as 50 per cent of the tax arising from the unreported income.

"Also," he noted, "the person avoids the risk of criminal prosecution for tax evasion, which could result in a fine of up to 100 per cent of the tax evaded and possibly jail."

In 2010, the CRA announced it would be clarifying its voluntary disclosure policy and procedures. In a discussion with the national

tax agency, Sohmer was informed that in the case of offshore accounts the CRA will look at income for only the last 10 years because Swiss banks are only obliged by law to maintain records for that period.

"This means that the opening capital will not be taxed (and) interest relief will be considered for all but the current three years," Sohmer noted, adding that, "This position complies with the law and strikes a balance between what taxpayers are willing to pay and what is fair to compliant taxpayers."

As a result, he said, "I anticipate a huge increase in the volume of disclosures by non-Quebecers with offshore accounts." (The tax rules in Quebec are different and, as a result, the new rule will not affect disclosure of offshore accounts in the same way as anticipated in other provinces).

The CRA will certainly continue to push the message home.



PINSKY

"Our strategy to uncover income and assets hidden in tax havens is education," said Brideau. "We want to ensure that Canadians are aware of the consequences of tax evasion, which are more serious than those associated with tax avoidance."

The common sense message is

resonating with many Canadians and their accountants.

"Getting off the hook with paying taxes and interest is a whole lot better than going to jail," said Pinsky. "The voluntary disclosure program as a whole is very useful for the CRA as they could recover billions of dollars that otherwise may not come to light."

In 2009, the CRA uncovered over \$1 billion in unpaid federal tax from Canadian taxpayers hiding assets and accounts offshore or through other international transactions. For the same period, it identified another \$138 million in unpaid tax through the voluntary disclosure program. Just five months into fiscal 2010, the number of disclosures had already exceeded the previous year.

Still, the CRA is doing more than waving an olive branch. "(We) have specially trained auditors and tax avoidance officers focusing on aggressive inter-

national tax planning, including the abusive use of tax havens, to ensure that Canadians are accurately reporting their income and paying tax," Brideau said.

The CRA will continue to work with other countries, he added. "We will continue to exchange information, share best practices and training material, share leads in accordance with our respective legislation, and we will continue to collaborate on compliance actions."

Last fall, for example, the federal government received information from the government of France about more than 1,000 HSBC accounts. Headquartered in London, England, HSBC Holdings plc is one of the largest banking and financial services organizations in the world.

The CRA is currently analyzing the account data to ensure that the Canadian holders are declaring all their income for tax purposes, and a series of audits have been launched.

## Practitioners Testify to Flaws in Canadian Voluntary Disclosure Program

by Kristen A. Parillo

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# WORLDWIDE TAX DAILY

## Practitioners Testify to Flaws in Canadian Voluntary Disclosure Program

by *Kristen A. Parillo*

A Canadian parliamentary committee on February 8 heard from U.S. and Canadian practitioners on how Canada can more effectively combat offshore tax evasion and encourage taxpayers to get into compliance.

The House of Commons Standing Committee on Finance has held several hearings on offshore bank accounts following the October 2010 revelation by Canada's CBC News and *The Globe and Mail* that French authorities gave the Canada Revenue Agency a list of nearly 1,800 accounts held by Canadian citizens in HSBC Private Bank's Geneva branch. The account information was included in data purportedly stolen between 2006 and 2007 by Hervé Falciani, a French citizen and former information technology specialist at HSBC's Geneva branch who later fled to France. (For prior coverage, see *Doc 2010-21377* or *2010 WTD 190-2*.)

Canadian lawmakers expressed outrage over the possibility that many Canadians could be hiding money in offshore accounts, and the Canadian Parliament subsequently passed a resolution to hold hearings on how the government can strengthen its tax enforcement efforts. David H. Sohmer, a partner with Montreal law firm Spiegel Sohmer, and Scott D. Michel, a partner with Caplin & Drysdale in Washington, spoke with Tax Analysts about the testimony they provided to the committee.

Sohmer said he sought in his testimony to expose problems faced by taxpayers and practitioners with the CRA's voluntary disclosure program (VDP), which has been in place since 1973, and to highlight how friction between the federal government and Quebec may result in a loss of tax revenue. Sohmer noted that Canada doesn't have the political and economic leverage to adopt an aggressive U.S.-style approach to combating tax evasion.

"There's a tendency to thump all over the CRA by some Canadians who have fantasies about being like

the IRS playing sheriff and beating up on UBS, scaring people into disclosing," Sohmer said. "The problem is that we just don't have that muscle — our population is too small."

Sohmer said that because of Canada's relatively smaller size, it can't strike a balance, as the United States tries to do, between having an iron fist — by going aggressively after offshore banks — and offering a velvet glove in the form of a high-profile, special voluntary disclosure initiative. Rather, Canada must focus on improving the attractiveness of its VDP to encourage Canadians to come forward.

Sohmer noted that the VDP is designed in theory to provide for a predictable set of acceptable outcomes and that the VDP's terms are generous: Penalties are waived for a period of 10 years before the year in which relief is requested, and interest is reduced for years other than for the three years preceding the year of disclosure. "The problem is that the CRA doesn't practice what it preaches," Sohmer said, adding that the CRA gives tax officers substantial discretion in determining which years should be included in a disclosure.

"There is no statutory authority to provide relief from penalties for years other than the 10 years preceding the application for relief," Sohmer said. "So if a taxpayer gives them 20 years of records, they have no statutory authority to relieve years 11 through 20."

A far bigger problem with the VDP, Sohmer said, is Quebec's refusal to harmonize its own voluntary disclosure program with the CRA's. "Unlike in the United States, where state taxation is not a critical component to the federal government, in Canada the tax revenue is shared almost fifty-fifty between the federal authorities and the provinces," Sohmer explained. The federal government has a tax collection arrangement with all the provinces except Quebec, which has its own distinct individual and corporate income tax act. Quebec also has its own VDP and decided not to harmonize it with the federal government's VDP.

"Quebec's Ministry of Revenue insists on taxing an account's opening capital in year 6 as if it were income

earned in year 6, despite the fact that there is no legislative authority for doing so," Sohmer said. "So where the portfolio has gone down in value, the tax on it can end up being confiscatory."

The result is that the federal government gets the short end of the stick, Sohmer said, adding that in one case he's handling now, the amount payable to the CRA is C \$169,000, while the amount payable to the Quebec authorities is C \$1.34 million. In another case, the amount payable to the CRA is C \$44,000 and to Quebec is C \$224,000. "Clearly that's not sustainable," he said.

Exacerbating the problem is that the so-called revenue rule, under which one sovereign state will not enforce the tax laws of another, can result in both Ottawa and Quebec getting the shorter end of the stick, Sohmer said. He explained that Canadians emigrate far more frequently to the United States than Americans do to Canada and that the revenue rule could prevent Canada and Quebec from collecting tax from emigrants when the tax liability arises under Canadian law because of an inheritance. He noted that Article XXVI A of the Canada-U.S. treaty (Assistance in Collection) is an exception to the revenue rule but that the provision likely doesn't apply to situations in which the tax liability of U.S.-resident children arises under Canadian law merely because of an inheritance.

"Both Ottawa and Quebec lose in that situation," he said. Even in situations in which a parent dies in Quebec and leaves his money to children who have moved to another province, it is arguable that the revenue rule would not allow Quebec to enforce its tax law in other provinces, Sohmer said.

"A failure to resolve the Quebec-Ottawa issue may result in a material reduction in potential tax revenue," he added.

"Ottawa is in a very difficult position, and I'm not sure this is something that can be handled legislatively," Sohmer said. "The Quebec-Ottawa problems have been with us for a long time. There are a lot of people who want to exploit this friction, and I think Quebec is exploiting this now."

However, with an election coming up, even the possibility of having billions of dollars repatriated to Canada by improving the voluntary disclosure process may not be enough to convince Ottawa to stir the pot and pick a fight with Quebec, Sohmer said.

### A U.S. Perspective

Michel said he gave an overview of the U.S. government's ramped-up enforcement efforts in the last three years following revelations that employees of Swiss

bank UBS helped U.S. clients hide assets in offshore accounts. Michel explained to the committee how the U.S. government "leveraged" the publicity from the UBS scandal to encourage more than 15,000 Americans with unreported offshore accounts to come forward through a special settlement initiative that offered reasonably certain, and capped, civil monetary penalties. (On the same day the hearing was held, the IRS announced details of a second special voluntary disclosure initiative. For prior coverage, see *Doc 2011-2714* and *2011 WTD 27-1*.)

Despite the extraordinary response to the IRS's special disclosure initiatives, Michel noted that the program did not run as smoothly as it could have, and he highlighted how the U.S. — or any other country developing a disclosure program — could design a more effective disclosure policy. He explained that a disclosure program should provide a clear path, without any sense of trickery or risk, for someone who has not been compliant to come forward and avoid criminal prosecution. Regarding liability for civil penalties, there should be a balance between a "one size fits all" approach and one that takes into account particular circumstances in a given case.

Michel added that once a taxpayer is accepted into the program, every effort should be made to process the matter efficiently and rapidly. Finally, any successful disclosure program should be combined with effective and highly publicized enforcement efforts, such as the U.S. Justice Department's prosecution of several UBS account holders and its pursuit of bankers, lawyers, accountants, and others associated with tax non-compliance.

Michel said that there seemed to be disagreement among the committee members on the benefits of having a voluntary disclosure program and that there were many back-and-forth questions as to where the government should draw the enforcement versus compliance line. "There were a couple of hard-liners who couldn't imagine why the tax authorities needed to exercise any degree of leniency, that if there was sufficient enforcement brought to bear, people would comply," he said. "And then there were people on the other side whose view was that yes, we should be enforcing the law, but if you don't provide people a clear way to come in, then you're going to lose on the compliance side."

"My sense of the room was that the leanings were more in the latter direction, that there was a recognition that you need to have a voluntary disclosure policy," Michel said. ♦

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