



# **Offshore Tax Enforcement: Voluntary Disclosure, FBARs and FATCA**

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# U.S.: Iron Fist and Velvet Glove Strategy Works

“If the IRS wants people to come forward voluntarily, it needs to couple its VDP with well publicized tax enforcement” (Scott Michel)

Taxpayers have made almost 35,000 disclosures since the voluntary program began in 2009. As of January 2012, the IRS has reported receiving \$4.4 billion.



# Canada: Velvet Glove and a Bark with Little Bite Works

1. Population 34 million: insufficient financial and human resources to act unilaterally.
2. Capital markets too thin for QI or FATCA legislation to be effective.
3. Swiss financial institutions have no material presence in Canada for effective domestic action. Swiss play a significant role in financing Canadian investments.



# Canada: Velvet Glove and a Bark with Little Bite Works

(Continued)

4. Bilateral agreements (treaties and TIEAs) of limited value because modeled on Article 26 OECD information exchange provisions: no automatic exchange of information and “fishing expeditions” prohibited.
5. Canadians like medicare and dislike handguns.
6. Prosecutors are career functionaries.
7. Parliamentary system of government elections every 5 years.



# **Canada: Velvet Glove and a Bark with Little Bite Works**

**(Continued)**

Taxpayers have made 7301 offshore disclosures from April 1, 2009 to March 31, 2011 (i.e. 20% of U.S. total).



# Why does Canadian VDP work?

1. Demographics: Most disclosers are golden-agers with university educated children who are Canadian born or U.S. persons.
2. The Canadian Securities Administrators, National Instrument 31-103, effective as of September 28, 2009: International dealers and advisers exempt provided they only act for individuals who own \$5 million + of financial assets. UBS and Credit Suisse contact Canadian clients.



# Why does Canadian VDP work? (Continued)

3. Highly publicized attack by IRS on UBS
4. LGT Treuhand, Liechtenstein – data theft in 2006: 106 Canadian residents holding CND \$100 million.
5. HSBC data theft: 1800 accounts held by Canadians.



# HSBC: Bark vs Bite

House of Commons Question Period:  
September 30, 2010

**Stephen Harper – Prime Minister:**

*Mr. Speaker, our position is very clear. If Canadians are using Swiss bank accounts to avoid paying taxes in Canada, those people will face the full force of Canadian Law.*

**Gilles Duceppe Laurier – Sainte-Marie, QC:**

*Mr. Speaker, what I am asking is if he will make an official request to France to obtain that list. Then, once the evidence is obtained, will the Prime Minister commit to not reaching an out of court settlement with the individuals in question, and instead recover the money and bring criminal charges against the guilty parties? The government should punish these white-collar criminals, who are costing it millions of dollars.*





# HSBC: Bark vs Bite

(Continued)

## Stephen Harper – Prime Minister:

*Mr. Speaker, once again, this government will not tolerate Canadians using Swiss bank accounts to avoid paying taxes.*

## Affidavit by CRA in HSBC Litigation:

15. Furthermore, the International and Large Business Directorate of the CRA, in regards to the HSBC Audit Project, has never disguised a criminal investigation for the purpose of assisting the Criminal Investigations Division of the CRA, but rather is performing exclusively and solely civil audits that have no past, or imminent investigative purpose.



# Voluntary Disclosure Program and Offshore Assets

- Each disclosure must meet the four conditions to be considered a valid disclosure by the CRA, regardless if the disclosure is for the failure to file a return or for the underreporting of income (voluntary, substantially complete, involves at least one penalty and information at least one year past due).
- 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.



# Voluntary Disclosure Program and Offshore Assets

(Continued)

- A decision to open statute-barred years must be based on the provisions of subsection 152(4)(a)(i) of the *ITA*.
- For unfiled tax returns, the CRA is obligated to assess as far back as there are returns to be filed.



# Subsection 152(4)(a)(i) *ITA*

1. “The Minister may at any time make an assessment [...] of tax for a taxation year [...] only if the taxpayer has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filling the return [...]”.
2. The Minister has the onus of proof.



# Subsection 152(4)(a)(i) *ITA*

## (Continued)

3. Current Federal Policy: Years for which documents and evidence are available:
  - Swiss Banks: 10 years
  - Caribbean and Hong Kong Banks: 7 years



# No-Name Disclosure

- Taxpayers are required to provide all disclosure information except their name at the time they make a submission, so the CRA may determine whether to accept it in the VDP.
- Have up to 90 days to identify themselves or the disclosure will be closed without further contact from the CRA.
- 90 day period will start the day that the CRA contacts a taxpayer or their representative to discuss the disclosure.



# Federal and Provincial Tax

## A. RATES:

1. Federal: 29% (after Quebec abatement: 24%)
2. Ontario: 19%
3. Quebec: 24%

B. Federal administers individual provincial tax for all provinces except Quebec.

C. Federal and Quebec exchange tax information.



# Federal and Provincial Tax

(Continued)

- D. Federal Form T1135 (*Foreign Income Verification Statement*): Penalty for false statement or omission is 5% of greatest amount in the year (based on cost). No T1135 equivalent in Quebec.





# Federal Policy

- Net income & net capital gains taxed each year for which bank statements are available (e.g. 10 years or 7 years depending on the bank).
- Opening capital is not subject to tax.
- Interest applied to overdue tax payable with 4% interest relief for statute-barred years.



# Federal Policy

(Continued)

- If taxable income or net capital gains can be determined for periods beyond 10 years, tax payable will be subjected to full interest rates and penalties (T1135, etc.) for stub period (*Bozzer*).
- Unexplained transfers taxed as income.
- Adjusted cost base (Basis) of stocks in opening capital is nil unless evidence of cost.



# Quebec Policy

- Net income & net capital gains taxed for 6 years.
- Opening capital taxed in its entirety unless it is proven to have tax-exempt or tax-paid origins.
- Interest charges:
  - Not applicable for statute-barred years and opening capital.
  - Applied at prescribed rates for last three years.



# Quebec Policy

(continued)

- Opening Capital Policy and Exchange Rate Policy for Statute-Barred Years:
  - Shares and similar assets included at 50% and exchange rates at actual Bank of Canada exchange rates.
  
- Cash, Bonds and Fiduciary Deposits included at 100% and exchange rates at December 31, 2009 Bank of Canada exchange rates.



# Issues

## A. Federal:

1. Transfers to “accomodators” taxed as income.
2. Establishing cost of stocks acquired more than 10 years ago.
3. Mail opened by customs.

## B. Quebec:

1. Unrealized reductions in value of portfolio (including F/X fluctuations)
2. Tax-paid funds acquired more than 6 years ago can result in tax on the increase in value.



# Issues

(Continued)

## C. Ethical:

1. Taxpayer possesses more than 10 years of bank records.
2. Deferring disclosures where deposits or withdrawals in disclosure period.
3. Deferring disclosures by Quebec residents where heirs do not reside in Quebec. Note no tax collection agreements with Canada, other provinces, or foreign countries.
4. Deferring federal disclosure by Quebec resident until death and ignoring Quebec. Net worth assessment less expensive than Quebec VDP.
5. Deferring disclosures by Canadian residents where heirs are U.S. citizens and no material assets in Canada.



# U.S. Citizens Resident in Canada

1. U.S. penalties (FBAR) and interest not creditable in Canada.
2. Foreign tax credits may not be available because of timing issues.



# **Exchange of Information: Article XXVII *Canada-U.S. Income Tax Convention***

1. Information exchanges are specific, automatic and spontaneous.
2. Canada automatically supplies U.S. with records where recipient has provided a U.S. address, including NR 4 – *Statement of amounts paid to non-residents* and T5 – *Statement of investment income*.





# **Exchange of Information: Article XXVII *Canada-U.S.* *Income Tax Convention***

(Continued)

3. Where information is found during the course of an audit that “may be of interest” to the U.S., the information is forwarded spontaneously. For 2001/2002, Canada received 18 spontaneous exchanges and sent 22.
4. There is no publicly available evidence that Canada provides the U.S. with information respecting U.S. citizens who are resident in Canada.
5. FBAR penalties arise under Title 31 of the U.S. Code and may not be within the scope of taxes covered by the Treaty.



# Assistance in Collection of Tax Debts: Article XXVIA *Canada – U.S. Income Tax Convention*

- Assistance is provided by Canada in collecting U.S. tax owing and interest and penalties ancillary thereto, but not if the individual is a Canadian citizen.
- FBAR penalties are not collectible because they are not income or capital taxes imposed under the Code or related penalties.
- Assistance is provided by the U.S. in collecting all taxes collected by or on behalf of Canada (i.e. includes provincial tax other than Quebec tax), but not if the individual is a U.S. citizen.



# **Assistance in Collection of Tax Debts: Article XXVIA *Canada – U.S. Income Tax Convention***

**(continued)**

- The “Revenue Claim” must not relate to a period in which the taxpayer was a citizen of the requested state “Quaere”. Is section 160 *ITA* liability a “revenue claim” (i.e. liability where property transferred at less than F.M.V.)?
- Canada has signed but not yet ratified the “Convention on Mutual Administrative Assistance in Tax Matters”. Canada will reserve against Articles 11 to 16 of the Convention so that it will not collect U.S. taxes from Canadian citizens.



# Cross Border Issues

1. A Canadian resident husband whose U.S. citizen Canadian resident wife has a POA on the account. They have been married and resident in Canada for 50 years. What if the account is joint?
2. A Canadian resident husband established a tax haven trust which owns a BVI company which has an offshore account. The husband died and his U.S. citizen Canadian resident wife is his sole heir.
3. A Canadian resident bequeaths an offshore account to his children, some of whom are resident in Canada and some in the U.S.



# Cross Border Issues

(Continued)

4. A Canadian resident U.S. citizen wife whose non-resident parents bequeathed an offshore account to her 15 years ago.
5. A Canadian resident U.S. citizen husband bequeaths an offshore account to his Canadian citizen and resident wife. Several years later she bequeaths the account to her children, some of which are Canadian residents and some U.S. residents.



# Thank You

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