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Practical Issues in Income Tax Disputes

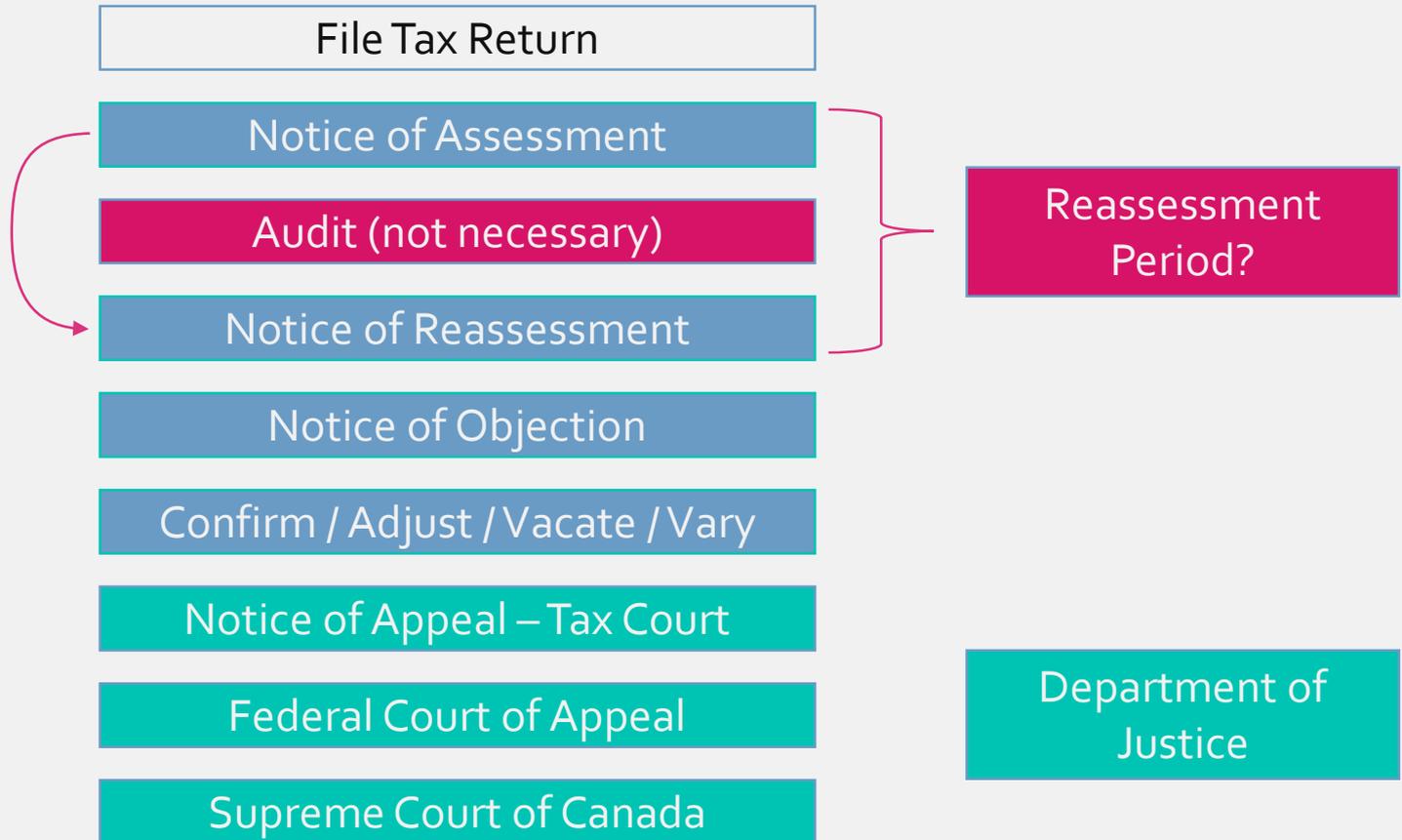
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Presentation Overview

1. The Tax Dispute Process
2. The Role of Voluntary Disclosure
3. The Audit and Reassessment
4. The Objection and Appeal

The Tax Dispute Process



Limitations on Reassessments

- Date of the initial assessment is critical
 - Individual/CCPC— Limited to 3 years
 - Other Corporations— Limited 4 years
- A waiver may extend the reassessment period indefinitely—If CRA
- requests a waiver—limit the scope of the waiver as much as
- possible.
- There is no limitation for reassessment where – there is a
- misrepresentation caused by carelessness, neglect, wilful default or
- fraud
 - It is important to assess whether a misrepresentation exists.
 - CRA policy is generally to investigate the current tax year and the preceding 6 years. (possibly less if the misrepresentation is minor).

Is There A Role For Voluntary Disclosures?

- Voluntary disclosure, if accepted, provides relief from penalties and prosecution (partial interest relief is also available).
 - The taxpayer must pay taxes and partial or full interest.
- Generally a taxpayer is only allowed to use the voluntary disclosure program once.
 - The taxpayer is expected to remain compliant after disclosure has been made.
 - A second disclosure may be allowed if the CRA considers the noncompliance beyond the taxpayer's control or when dealing with a corporate entity (e.g., when two different departments submit a Voluntary Disclosure)
- The CRA will only grant relief within a 10 year window from the taxpayer's submission.

Conditions for Voluntary Disclosure

1. Must be voluntary (no CRA enforcement activity) “voluntary” means that the taxpayer must not be aware of :
 - I. any enforcement action directed towards the taxpayer that is currently underway or about to start (e.g.. audit or a demand to file return); **OR**
 - II. any enforcement action directed towards a related party that is likely to uncover the information being disclosed.
2. Must be complete.
 1. Full and accurate facts and documentation for all taxation years where there was previously inaccurate or unreported information (cannot guess).
 2. Full disclosure must be made within 90 days. Extensions are possible where the taxpayer can demonstrate that full information cannot be supplied within the 90 day time limit.
3. Disclosure must involve the application of a penalty.
4. Disclosure must include information that is at least 1 year past due.

No Names Voluntary Disclosure

- Disclosure can start as “no-names” (discussions are informal, non-binding and general in nature).
 - The taxpayer must make full disclosure and provide his or her identity within 90 days of the Effective Date of Disclosure or choose not to proceed.
- If the taxpayer does not proceed they are subject to the risk of discovery.
 - The CRA has indicated that they do not actively search for the identity of taxpayers who do not proceed with full disclosure (e.g., no forwarding information to Audit).
- The parameters surrounding full disclosure may be able to be negotiated with the CRA after making a no names disclosure.
 - Experience of late is that CRA Voluntary Disclosure Officers much less willing to engage in such discussions until submission of “Named” disclosure.

Following up on Voluntary Disclosure

- Traditionally the CRA has requested extensive information/figures following the submission of a voluntary disclosure.
- However, the CRA has indicated that it will be (and, based on experience, it appears to be) moving towards a less “audit like” system.
- Inaccuracies in the voluntary disclosure are still subject to audit and reassessment.
- Information regarding 3rd parties that are “implicated” within a voluntary disclosure may be sent to other CRA sections but the CRA has indicated that these leads are not followed up on by the Disclosures section.

Voluntary Disclosure and the Problem with Records

- Once a voluntary disclosure is made, full disclosure is required.
 - Full disclosure means disclosing everything no matter how old.
- Relief is limited to 10 years, but disclosure requirement is not.
 - A full disclosure may involve taxation years prior to the 10 years for which relief may be provided.
- The CRA will only accept disclosures of amounts for taxation years where there is some evidence of the amounts disclosed/at issue/tax owing.

Voluntary Disclosure and the Problem with Records

- However, the better or more complete the records a taxpayer has, the further back the CRA may possibly go.
- Effectively, the taxpayer is potentially penalized for maintaining good records—particularly where an innocent error gives rise to voluntary disclosure.
- CRA general policy is to limit an audit to the current tax year and the preceding six years when a misrepresentation has occurred.

The Audit

- The CRA has initiated multiple programs to examine/encourage compliance
- of various groups.
 - Initiative to review high net worth (>50 M) individuals.
 - Certain taxpayers with TFSAs.
 - Charities.
 - Waiters/waitresses (tips)/service industries (zapper software).
 - Home builders/Contractors.
 - Partnerships with other entities—Canadian Home Builder's Association, Federal/Provincial Territorial Underground Economy Working Group, Trade School Initiative, OECD
- Audits can also arise from leads arising through other audits or anonymous disclosures—the CRA uses the internet too!
- Initial CRA requests for information can lead to significant audits which will often look back more than the 3 or 4 statute barred years.

The Audit

- The CRA may issue a letter inviting the taxpayer to disclose –
 - The CRA requests information relating to a perceived “discrepancy” and states that if no discrepancy exists, no further action is necessary, but if error or omission—fix it now.
- If the issues under audit are industry specific it may be helpful to request assistance from industry specialists at the CRA or elevate your concerns to head office.

Waivers and the Normal Reassessment Period

- It is against CRA Policy to ask for a waiver simply to allow more time for the CRA to reassess.
- The waiver should always be to the Taxpayer's benefit.
- Waiver may facilitate a submission responding to a proposal letter and thereby potentially reduce the quantum of a subsequent reassessment and the breadth of issues which must be addressed in a notice of objection.
- Waiver may also be a strategic tool for taxpayer
- Language of the waiver must be limited to the specific issue under consideration.
- Provide separate waivers for each issue in each tax year

Waivers and the Normal Reassessment Period

- Multiple reassessments can be based on the same waiver.
- Be attentive to revoking waivers—6 month notice
- Consider granting and revoking waiver at the same time.

The Never Ending Audit

- Once an audit has been initiated the CRA auditor is required to abide by CRA policy and must consider 5 key principles:
 - Legislative Authority, Intent, Relevance, Transparency and Impartiality.
- Auditors are mandated by the CRA to reach negotiated settlements and avoid the cost of Objections / Tax Litigation where possible.
- The CRA's policy is generally not to reassess on issues that were or should have been dealt with in previous audits.

Audit Management – CRA Policy

- If a broad based request for “all documents” is made, the auditor should be asked to focus on the specific issues under examination.
 - It is CRA Policy for Auditors to clearly identify the particular transaction, claim or issue being reviewed.
- It is the CRA’s policy to refrain from seeking information from a 3rd party unless this information cannot or will not be provided by the taxpayer.
- Although the CRA has been given broad powers under the Income Tax Act to access Taxpayer information, they are limited by the Richardson purpose test.
 - The CRA’s purpose for seeking the information must be supported by a genuine and serious inquiry into the tax liability of a specific person or persons.

Audit Management – Manage Information Flow

- When faced with an audit take immediate control over how information flows from the taxpayer to the CRA.
- Establish a single point of contact.
 - Multiple contacts between an organization and the CRA can result in miscommunication, misunderstanding, missed deadlines and unnecessary expansion/extension of an audit.
- Ensure everything is put into writing
 - Record all requests made by the CRA. Ensure the time and nature of each request is recorded.
 - Record when requests are satisfied and when any information or documents are given to the CRA.

Audit Management – Making Progress

Steps which might be considered when faced with a never ending audit or an auditor who has taken an extreme position.

1. Try to avoid the situation by meeting with the auditor and carefully managing audit--(e.g., obtain a list of issues, CRA groups involved, what is being requested at the outset of the audit, assign contact person, etc.)
2. Discuss audit strategy with the taxpayer's counsel.
3. Organize face to face meetings between the CRA and the taxpayer's counsel.
4. Engage the auditor's supervisor.
5. Engage the assistant director of enforcement within the local Tax Services Office.
6. Engage head office - go to the auditor's functional leader or the Rulings Directorate.

The 30 – Day letter

- It is important to check the 30-day letter to ensure the auditor's version of the facts is correct and determine if inaccurate assumptions are being made.
- After reviewing the facts, formulate the arguments that will oppose the auditor's technical interpretation.
- Submissions in response to 30-day letter can form the backbone of a notice of objection.
- Critically important to respond to 30-day letter. Do not assume that the CRA will move off its position.
- Carefully draft the response. Language can play an important role in minimizing the time/cost of resolving the dispute.

Notice of Reassessment

- Ensure you understand the issues behind the issuance of the reassessment --- additional issues may have arisen that were not previously considered.
- If the issues are not clear, request clarification from the CRA.
- Double check for statute-barred issues.
- Obtain Auditor's Report and Penalty Report (if applicable)
- Confirm filing deadline for notice of objection, or if required, request a loss determination.

Filing Deadlines for a Notice of Objection

- Individuals/Testamentary Trusts
 - 90 days after the date of the sending of assessment
 - 1 year after filing due-date
- Corporations/Trusts
 - 90 days after the date of the sending of assessment
- Can apply to the Chief of Appeals for an extension to file objection – if refused, can apply to the Tax Court of Canada
 - Applications must be brought within 1 year of the original 90 day deadline—if not the granting of an extension will be statute-barred.
 - Allowing an application for late-filing is at the Minister's discretion.

Restrictions on Collection

- Generally, for individuals and many corporation,
 - CRA will send a demand letter and take collection action 90+1 days following the notice of assessment/reassessment.
 - Collections will often contact taxpayers prior to the time they are entitled to collect to “inquire” about whether an objection will be filed, or tax will be paid—taxpayers should refer these inquires directly to taxpayer’s counsel
 - CRA is prohibited from taking collections action until 90 days after a decision is issued in regard to objection/appeal.
- For Large corporations (taxable capital > \$10 million), the CRA is permitted to collect 50% of the amount assessed during the first 90 days after mailing the reassessment.
 - Large corporations may post security in order to satisfy the 50% demand.
- Collection restrictions do not apply to certain matters (e.g., GST/HST remittance, tax which should have been withheld at source, NR withholding).

Restrictions on Collection

- If the objection is found to be “frivolous or groundless” a penalty of 10% of the tax owing may apply.
- CRA may collect using “set-off,” garnishment, legal proceedings, seizure and sale of goods and chattels, etc.
- Consider the provincial collection rules. They do not necessarily match the rules in the Act.
- Despite filing objection, compound non-deductible interest is still accruing and taxes remain outstanding.
- Be vigilant. Often the CRA will attempt to collect when they have no power to do so.

Notice of Objection

- CRA prefers detailed objections, though they are generally not required .
- Large corporations are required to raise all issues, relief sought, facts and reasons in the objection
 - Only the issues raised and the relief sought in the objection may be appealed to the Tax Court of Canada.
- Drafting should be a cooperative effort with the taxpayer's accountant or financial professional.
- Careful of provincial only issues – these may require separate objections

Notice of Objection

- A taxpayer cannot object to a nil assessment, except in very limited circumstances.
- If a loss incurred by taxpayer in year is reduced, the taxpayer must obtain Loss Determination.
- The 90 day period for filing an objection and the 3-4 year reassessment period starts once the determination is issued by the CRA (i.e., Minister can reassess a subsequent year to deny loss carried forward)
- If don't object in year loss is reduced by assessment, can still object in subsequent year where there is taxable income and the loss carry forward.
- If new reassessment for the disputed tax year after the objection has already been filed – the old reassessment and objection are nullified and a new objection must be filed.

Access to Information

- Informal requests can be made to access information that the CRA used to support its reassessment.
 - Auditor's report, internal correspondence, record of communications with taxpayer's representatives, audit working papers and related reports from CRA valuers, appraisers or external consultants.
- The CRA Policy Manuals can provide insight into the positions taken by the auditor.
- If an informal request is unsuccessful .
 - Remind the auditor it is CRA policy to satisfy informal requests (transparency and fairness)
 - Escalate concern to Team Leader or Assistant Director of Audit.
 - Consider using formal request via the Access to Information Act

Judicial Review

- Judicial Review to challenge unreasonable decisions made by the CRA.
- No parallel proceedings in Federal Court and Tax Court of Canada (s.18.5 *Federal Courts Act*)
- Challenge—*JP Morgan Asset Management (Canada) Inc.* decision:
 - Federal Court does not have jurisdiction to address CRA misbehaviour in respect of issuance of an assessment.
 - Decision to issue assessment and content of assessment (amount payable or determined) are not matters of Ministerial discretion.
 - Judicial review is a method of last resort that may only be invoked where no other avenue for relief available. TCC appeal process provides effective relief where assessment incorrect, where evidence shouldn't be admitted to support assessment, where abuse of TCC process, where procedural defect in process of assessing.
 - If taxpayer can't/does not obtain relief through TCC appeal process, taxpayer may obtain relief through provincial civil courts for improprieties such as negligence, fraud or misfeasance.
 - FCA recognized still “well-recognized tax areas” where judicial review may potentially be available—taxpayer relief, discretionary assessments, unacceptable conduct during collection matters.

Settlement

- Seek out opportunities to meet with CRA Appeals Officers
 - Recognize you are dealing with an Appeals Officer (not a Department of Justice lawyer).
 - Try to determine “sticking” points and make submissions on these points.
- Currently “split the difference” settlements not permitted.
 - Settlements must be based on a reasonable interpretation of the law.
 - Legislative proposals have been made to allow “split the difference” settlement.
- Look for opportunities based on different tax years.
 - Reassessments of statute-barred and non-statute-barred years.
 - Different issues in same taxation year.
- Try to work interest relief into settlement (often unsuccessful).
- If “spinning wheels” consider requesting confirmation and proceeding to Tax Court of Canada—this may be case if pure questions of law or contentious relationship with CRA.

Beyond Settlement

- Consider taxpayer relief applications for relief of interest and penalties
 - 10 year limitation (*Bozzer*)
- If appropriate, consider requesting the reassessment of statute
- barred years (restricted to individuals and testamentary trusts)—s.s. 152(4.3)
- *Financial Administration Act* relief.

Notice of Appeal

- Dealing with the Department of Justice different from dealing with CRA officers.
 - May be opportunities for resolution that were not available with CRA officers.
- Deadline is 90 days from the day the Minister sent Confirmation
- Procedure in Tax Court of Canada is governed by *Tax Court Rules*
- *General Procedure* and *Informal Procedure* in Tax Court appeals
 - *Informal Procedure*—amount of federal tax and penalties disputed , excluding interest, per taxation year is \$25,000 or less or if amount of loss determined is \$50,000 or less, or only subject matter of appeal is interest assessed, taxpayer may elect (in Notice of Appeal) to proceed under *Informal Procedure*



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