Canadian Assets in the Offshore World

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Canada's present federal government was elected on 19 October 2015. In its budget tabled 22 March 2016, the new government recognized "the importance of protecting the integrity of its tax base and ensuring that everyone pays their fair share". It also affirmed the country's active involvement in international efforts to address base erosion and profit shifting. On 11 April 2016 the new government announced the creation of the Offshore Compliance Advisory Committee.

What follows is an introduction to the international tax measures being taken by Canada's newest government, and an overview of a high profile court challenge by Canada Revenue Agency to an Isle of Man tax shelter structure, that is very much in the Canadian news.

A.) ISLE OF MAN OFFSHORE COMPANY STRUCTURE

Peter Marshall Cooper v. The Queen Court File No 2015-1070 (IT) G;

Background facts

According to pleadings filed in court on behalf of Mr Cooper ("**Appellant"**), advice from KPMG LLP and a Canadian law firm reflected the following course of action. In 2001 a corporation Ogral Company Limited **("Ogral Co"**) was established under Isle of Man legislation. Ogral Co was appointed a beneficiary of a trust, of which the Appellant and certain members of his family were also beneficiaries. The corpus of the trust was distributed to Ogral Co as a beneficiary of the trust. Ogral Co earned interest and dividend income, realized gains and losses, and incurred expenses for management services. The assets (roughly CAD $26 million) were at no time acquired by the Appellant or his family, nor could they require Ogral Co to transfer any of its assets to them. The Appellant and his family were not officers, directors or shareholders of Ogral Co. Ogral Co's constating documents permitted, but did not require, except on dissolution, the Board to make gifts of its assets to "Eligible Persons", but did not stipulate which "Eligible Person". The Appellant and his family were "Eligible Persons".

Appellant did from time to time request that the directors make gifts to him or other members of his family. The directors gave due consideration to such requests, and approved such gifts from time to time. According to pleadings filed in court by the Minister, a refusal to such request never occurred.

According to pleadings filed in court by the Minister, for over 8 years the Appellant and his sons earned income from their foreign investments exceeding CAD $4 million which they did not report.

In March 2012 Notices of Assessment and Reassessment were issued by the Minister for the Appellant's tax years 2003 to 2010 inclusive. The notices assessed penalties and interest in the following amounts (CAD): over $3.5 million for unreported interest and other income, almost $1.4 million for a gross negligence penalty, over $4.8 million in foreign reporting penalties.

The basis asserted by the Minister in its pleadings filed in court are: the Appellant was the "true owner" of Ogral Co's investment account: the formation and maintenance of Ogral Co constituted a "sham"; the Appellant knew this, and was "willfully negligent" in failing to report the same, and as a consequence, the "normal assessment period" did not apply. The Minister further asserts Ogral Co was holding the Ogral Co accounts as agent or nominee for the Appellant and his sons who were the *de facto* shareholders and directors of Ogral Co. (Related appeals by the Appellant's sons are ongoing as Court File Numbers 2015-1068 (IT) G and 2015-1069 (IT) G).

On 9 December 2012: following the taxpayer's objections, MNR confirmed the assessments triggering this appeal to the Tax Court of Canada.

Appeal

The issues in the appeal include: whether the Appellant is the "true owner", if so whether any part of the assessment is beyond the "normal reassessment period" and therefore statute barred, and whether the penalties are appropriate.

No hearing date for the appeal is disclosed in the court records. A case conference has been scheduled for 16 May 2016.

MNR v. KPMG LLP Court File No. T-283-13

Background facts

Two months after confirming his assessments in the Cooper case, on 18 February 2013 the Minister moved *ex parte* for an order under section 231.2(3) of the Income Tax Act, authorizing him to impose on KPMG LLP a requirement to provide information and documents as follows:

> 1. A list of KPMG clients who participated in the KPMG LLP tax product known as "Offshore Company" or "Offshore Company structure" ("OCS") at any time since January 1, 1999, including:
>
> a. the client's name and address;
>
> b. the name and address of the offshore company used as part of the OCS; and
>
> c. the date KPMG was engaged to set up the respective OCS.
>
> 2. Copies of the OCS related documentation and correspondence pertaining to such clients, including but not limited to engagement letters, planning documents, agreements, meeting minutes, other letters and emails.

That Order was made 18 February 2013.

On 7 March 2013 KPMG LLP moved for an order quashing the *ex parte* order, and declaring the sections of the Income Tax Act which authorized it, of no force or effect, on the ground they unjustifiably infringe the protections of life, liberty and security of the

person and against unreasonable search or seizure, contained in the Canadian Charter of Rights and Freedoms.

Over the next two and a half years KPMG LLP and MNR pursued confidential and without prejudice discussions with the aim of resolving the matter. In September 2015 the parties advised the court it had been determined that a hearing will be necessary.

KPMG LLP's application to quash the 18 February 2013 order has been fixed for hearing in Toronto for three days, commencing 24 January 2017.

The case in the Canadian Press

The case broke in the Canadian press in August 2015. It has received a lot of attention in the Canadian media. KPMG LLP has declined to speak to the Canadian Broadcasting Company about the allegations citing professional standards and obligations of confidentiality, as well as the *sub judice* rule. Internal KPMG LLP documents outlining the product have been leaked to the press.

B.) TAXING OFFSHORE STRUCTURES: THE LAW IN CANADA

New offshore trust provisions

- Became law in 2013 with retroactive effect until 2007
- Eliminates requirement for resident beneficiary. Trust can be caught even if no Canadian resident beneficiary, if there is a Canadian contributor
- Expands concept of contribution to a trust
- Trust property is now divided into resident portion and non-resident portion
- Trust is deemed to be a resident of Canada and all income of the trust relating to the resident portion is taxable

- Income from resident portion is attributed to resident contributors in proportion to relative contributions to the trust
- Income from non-resident portion is not taxable in Canada provided the trust is an "electing trust"

The Carrot and the Stick

a.) The Stick: Potential Income Tax Penalties

A key issue will be how the CRA handles advisors such as KPMG LLP, whose clients the agency is pursuing over their involvement in a tax shelter based in the Isle of Man. Section 163.2 of the ITA provides for two penalties, one directed primarily at those who prepare (or participate in), sell or promote a tax shelter or tax shelter-like arrangement ("planner penalty"), and the other directed at those who provide tax-related services to a taxpayer ("preparer penalty").

"Planner Penalty": Examples of when this subsection could be applicable are:

- tax shelter promoters holding seminars or presentations to provide information in respect of a specific tax shelter; and
- appraisers and valuators preparing a report for a proposed scheme/shelter that could be used by unidentified investors.

The penalty amount is the greater of $1,000 or the total of the person's gross entitlements for the planning or valuation activity (calculated at the time at which the Notice of Assessment of the penalty is sent to the person).

"Preparer Penalty": Applies to a person who makes, or participates in, assents to, or acquiesces in the making of a statement to, by or on behalf of another person that the person knows, or would reasonably be expected to know but for circumstances

amounting to culpable conduct, is a false statement that could be used by or on behalf of the other person for a purpose of the ITA. Examples include:

- a person preparing a tax return for a specific taxpayer;
- a person providing tax advice to a specific taxpayer; and
- an appraiser or valuator preparing a report for a specific taxpayer or a number of persons who can be identified.

Criminal Offences

> **Income Tax Act R.S.C.1985, c.1**
>
> **s. 239 (1) Other offences and punishment —**
>
> Every person who has
>
> (a) made, or participated in, assented to or acquiesced in the making of, false or deceptive statements in a return, certificate, statement or answer filed or made as required by or under this Act or a regulation,
>
> (b) to evade payment of a tax imposed by this Act, destroyed, altered, mutilated, secreted or otherwise disposed of the records or books of account of a taxpayer,
>
> (c) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to enter a material particular, in records or books of account of a taxpayer,
>
> (d) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act, or
>
> (e) conspired with any person to commit an offence described by paragraphs (a) to (d),
>
> is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to
>
> (f) a fine of not less than 50%, and not more than 200%, of the amount of the tax that was sought to be evaded, or
>
> (g) both the fine described in paragraph (f) and imprisonment for a term not exceeding 2 years.

b.) The Carrot: Canada's Voluntary Disclosure program (VDP)

The VDP permits a taxpayer to voluntarily disclose noncompliance and to correct tax-reporting and payment deficiencies in exchange for penalty and possible interest relief. To be accepted under the VDP, a disclosure must generally (1) be voluntary, (2) be complete, (3) report non-compliance that otherwise might attract a penalty, and (4) involve noncompliance that is at least one year past the compliance's due date.

The CRA report notes the significant increase in the number of voluntary disclosures under the VDP in the past year:

- More than $1.3 billion of unreported income was voluntarily disclosed under the VDP, a 65 percent increase over the previous year.
- Of the unreported income disclosed under the VDP, $780 million was attributable to offshore holdings, a 157 percent increase over the previous year.
- Under the VDP, 19,134 voluntary disclosures were made, a 21 percent increase over the previous year.

The CRA's new offshore tax informant program (OTIP)

OTIP offers financial awards to an individual who provides information relating to certain types of "major international tax non-compliance." Over the past year, the CRA received 1,920 separate contacts from potential informants under OTIP, leading to over 200 written submissions and 110 cases that are currently under review.

Has Canada's new government changed the focus?

The Isle of Man investigation is part of a campaign to target four different foreign jurisdictions every year where Canadians are moving large sums of money.

To do the work, the CRA is adding 100 new auditors. The agency is also increasing its audits of "high-risk" taxpayers to 3,000 a year from 600 and will review the activities of

200 tax shelter promoters, including accountants and financial consultants, up from fewer than 20 a year now.

The government also said it will step up prosecutions by "imbedding legal counsel" within its investigation teams to detect cases of tax evasion.

Effective January 1, 2015, certain financial intermediaries are required to file specific identifying information with the CRA in connection with cross-border electronic fund transfers in excess of $10,000. The CRA indicated that it was notified of approximately 3 million international electronic fund transfers during the first three months of the 2015 calendar year.

Offshore Compliance Advisory Committee

On April 11, 2016 the Minister of National Revenue announced the creation of an independent advisory committee on offshore tax evasion and aggressive tax planning to build on the measures established through Budget 2016. The Offshore Compliance Advisory Committee (OCAC) will be composed of seven independent experts with significant legal, judicial and tax administration experience.

The members will provide input to the Minister and the CRA on additional administrative strategies for offshore compliance to build on the Budget 2016 investment.

Its initial areas of focus will include:

- Strategies to help alleviate and discourage offshore non-compliance;
- Administrative policies being used by other tax administrations to address this global issue;
- Advice to the CRA in moving forward with its measurement of the tax gap;
- Additional strategies and practices related to promoters of tax schemes; and
- Potential ways to improve the CRA's criminal investigation functions.

2016 Budget related announcements

The 2016 budget also includes measures seeking to improve the integrity of Canada's tax system, while increasing revenue.

- Over the next five years, the CRA will receive $444.4-million to address tax evasion and aggressive avoidance through hiring extra auditors and specialists, developing robust business intelligence infrastructure, increasing verification activities and improving the quality of its investigations of criminal tax evaders. The expected five-year return on investment is estimated at $2.6-billion.

- In 2016 , using amnesty under the voluntary disclosures program, the CRA is on track to identify $1-billion in income that would otherwise have been hidden – an increase of almost 400 per cent over six years. Through enforcement, the CRA is on track to complete more than 9,000 audits of aggressive tax planning this fiscal year, with an estimated $1.6-billion added to the public purse.

- The government announced its intent to adopt the spontaneous exchange of tax information minimum standard included in the BEPS Action 5 recommendations, and to begin exchanging tax rulings in 2016 with other participating jurisdictions. The BEPS Action 5 minimum standard includes tax rulings related to preferential regimes and to conduits.

Offshore Trust Structures that remain Valid

- The granny trust (non-resident trust with a non-resident contributor who remains non-resident)

- Outbound trust (taxpayer is emigrating from Canada)

- Immigration trust (eliminated after 2014)