Wealth under the spotlight

In the wake of the global downturn, governments around the world are looking more and more for ways to boost depleted tax revenues. Many countries’ tax authorities – including the Canada Revenue Agency (CRA) – are taking a harder look than ever before at how they engage with high-net-worth individuals and their related economic entities.

The CRA has established a program called the Related Parties Initiative – also referred to as the High-Net-Worth Project – which targets wealthy individuals and related groups comprising 30 or more entities for in-depth audit. And while the CRA defines “wealthy” for purposes of this initiative as net assets of $50 million or more, you or someone in your family could still be targeted if your net worth falls below the stated threshold, but is still significant. The CRA has substantially increased its resources in this area and is casting a wider net than ever before.

Are you ready if the CRA comes knocking?

Are you ready if you're challenged?

You could be at risk of catching the CRA’s attention if you or your family has significant net worth and interest in groups of 30 or more related entities.

If so, you need to ask yourself:

▪ What are your potential exposures? Consider all your investments in corporations, partnerships, trusts, joint ventures and private foundations, and your domestic and foreign bank holdings.

▪ Do you have the necessary documentation that the CRA will demand?

We can help. Before responding to any requests from the CRA, consult your Ernst & Young advisor.
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What is the Related Parties Initiative?

Tax administrations in different countries communicate with each other frequently and share best practices. The Related Parties Initiative started as a CRA pilot project in 2005, based on a similar initiative of the Australia Tax Office called the High Wealth Individuals Taskforce. Since the Australian taskforce was achieving good results, the CRA decided to implement a similar program of its own.

While traditional audits have a relatively limited scope that tends to focus on a particular entity, the Related Parties Initiative is much more comprehensive, encompassing all related entities. And even though the initiative has been around for a few years, it has become more visible recently as a result of past audits being concluded and new audits being initiated.

Its profile was also raised with the publication of a 2009 Organisation for Economic Co-operation and Development (OECD) study called Engaging with High Net Worth Individuals on Tax Compliance, which was commissioned by the OECD’s Forum on Tax Administration, composed of about 40 tax authorities including the CRA.

Among other things, the study recommended that tax authorities establish an appropriate structure to deal with perceived tax compliance issues with wealthy individuals. It noted that nine countries, including Canada, had already done this. A number of additional tax administrations have followed suit since then, most notably the US Internal Revenue Service, which set up a high wealth unit in 2009.

The Related Parties Initiative has also gained a higher profile because of the tax authorities’ general and growing concerns over the possible “offshoring” of unreported income by high-wealth individuals in low-tax jurisdictions, including so-called “tax havens.”

What should I expect if I’m targeted?

The CRA is requesting targeted taxpayers to complete a 20-page questionnaire, form T997, which probes for information about a variety of related economic entities, including corporations, partnerships, trusts, joint ventures and private foundations. Requested information includes foreign and domestic bank or investment holdings, copies of the minutes of corporate board of directors’ meetings, corporate minute books, listings of legal and accounting firms used, correspondence files and tax-planning documents.

If the CRA requests that you complete its questionnaire, it’s imperative that you consult your Ernst & Young tax advisor before responding. We have deep experience and knowledge helping our clients deal with CRA audits. And in addition to our seasoned tax practitioners, we offer you the unique added capabilities of our alliance with Couzin Taylor LLP, one of Canada’s largest tax controversy law practices. Together, we can help you understand the scope and nature of the potential audit, advise on the documentation you need to prepare, and assist you with drafting your submission to the CRA.

Even if you haven’t been contacted by the CRA but think you may fit the criteria for a high-net-worth audit, you should consult your tax advisor.

You should also know that if you’re targeted, your family members — including your spouse, children and other relatives — will also be included in the audit. Tax filing mistakes or omissions can have serious consequences. It’s usually in your best interest to file an amended return voluntarily rather than waiting to see if the CRA discovers a discrepancy. Making a formal Voluntary Disclosure may also be an option, depending on the facts and circumstances.

A visible initiative aimed at the wealthy can have a positive spill-over effect on the compliance behaviour of other taxpayers.
Why are wealthy Canadians being targeted now?

Although wealthy individuals make up a small fraction of taxpayers, there are several key reasons why governments around the world are targeting them as a source of increased revenues.

First, the wealthiest members of society already pay a relatively large proportion of the income tax that governments collect. In Canada, for example, the top 1% of taxpayers account for more than 22% of total federal personal income tax paid. So from a compliance perspective, it makes sense for governments to tailor specialized programs and activities that specifically address this segment.

Second, clamping down on the wealthy is often politically expedient. With unemployment still stubbornly high in many developed economies, governments are often comfortable engaging in a highly visible initiative that increases taxes on the wealthy, which is often perceived by the public as a “fair” way of dealing with wealth inequality. In addition, a visible initiative aimed at the wealthy may have a positive spill-over effect on the compliance behaviour of other taxpayers whose assets and incomes fall below the target level.

Third, high-net-worth individuals generally have more complex financial affairs than other people, so they demand greater scrutiny. The wealthy are often internationally mobile, have multiple business interests and spread their assets across a range of trusts, partnerships or foundations.

This complexity has traditionally presented a significant challenge to tax administrations, which have typically looked at individual components of wealth in “silos” across different departments, rather than combining them together in a single, integrated audit. The Related Parties Initiative seeks to rectify this.

Fourth, the wealthy are more likely than others to engage in aggressive tax planning, simply because they have more complex financial affairs and are more likely to be able to access these services. This isn’t meant to imply that most wealthy individuals pursue aggressive tax planning – it’s simply that they have greater opportunity to use these techniques if they desire.

In its Study into the Role of Tax Intermediaries, the OECD noted: “High-net-worth individuals are the second principal market for aggressive tax planning.”

Combined capabilities, global reach

**Ernst & Young and Couzin Taylor**

A CRA audit can place a major disruption and strain on your business. It demands a significant investment of time, energy and resources, and the outcome is never certain. Having seasoned advisors at your side can make all the difference.

At Ernst & Young, our nationwide team of experienced tax controversy advisors joins forces with the tax lawyers of Couzin Taylor LLP – which is allied with Ernst & Young in Canada – to help you manage tax controversies through all administrative phases of the audit and resolution process. Our combined capabilities make us Canada’s largest tax controversy team. And since we’re part of the global Ernst & Young organization in more than 140 countries, we can assist you in different tax jurisdictions around the world.

Together, we can help you deal with all aspects of the assessment process. From opinions and risk assessment through audit, objection and appeals, we can advise on a broad range of contentious tax matters. We work closely with you and your other professional advisors to deal effectively and efficiently with disputes.
Is this initiative a sign of things to come?

The Related Parties Initiative should be viewed in the broader context of a fundamental transformation in the way tax authorities in different countries co-operate with each other on compliance matters. The global downturn and financial crisis served as a massive catalyst for change in facilitating greater exchange of tax information between jurisdictions and encouraging joint action.

Tax administrators around the world are refining their risk assessment techniques, partly through improved disclosure and greater transparency requirements, increased use of electronic filing requirements and, in many cases, by establishing units with a specific focus on large businesses or high-net-worth individuals.

The CRA has implemented a number of these changes over the last five years using new funding in the 2005 and 2007 federal budgets aimed at international aggressive tax planning. It actively uses a broad network of bilateral tax treaties to obtain tax information on Canadian companies and residents from other countries. Canada and other OECD member countries have also recently signed a series of Tax Information Exchange Agreements with low-tax jurisdictions – including countries that have traditionally been tax havens – that now give the CRA the legal means to obtain tax information from them as well.

Under the auspices of the G20 and the OECD, co-operation between tax administrations has become the rule rather than the exception. There’s now zero tolerance for tax evasion.

If the CRA comes calling, you need to be prepared.

Contact us

If you’ve been contacted by the CRA or if you think you’re at risk for an audit – or if you simply have questions about the Related Parties Initiative – please contact us today.

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To learn more about how tax administrations around the world are intensifying their scrutiny of wealthy individuals, read our new global report, Wealth under the spotlight, at ey.com/WealthSpotlight.