Using Tax Havens to Avoid Paying Taxes

Worth the Risk?

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Canada Revenue Agency
Agence du revenu du Canada

Canada

Introduction

This publication is intended to inform Canadians about the risks and consequences of using bank secrecy jurisdictions, commonly known as tax havens, to avoid paying taxes, and to explain what the Canada Revenue Agency (CRA) is doing to fight the abusive use of tax havens.

Although the vast majority of taxpayers voluntarily fulfill their tax obligations, some individuals and businesses look for ways to avoid paying their required share. In doing so, they place an unfair burden on other Canadians and erode government programs from which we all benefit.

Canadians who use tax havens to hide assets or avoid taxes should know that the CRA is working within Canada and with international partners to address this. Canadians should also be aware that the CRA is actively pursuing those individuals and organizations that promote tax havens as a way to avoid paying tax. We have significantly strengthened our international audit and compliance programs aimed at abusive schemes that use offshore jurisdictions, and we are working closely with other countries.

Tax havens in context

Under our self-assessment system, Canadian residents are required to report their worldwide income. When Canadian residents do not report all of their income—when they use tax havens to conceal assets and income that are subject to tax in Canada—the CRA gets involved.

Generally, a tax haven is a jurisdiction with one or more of the following:

- no tax, or very low rates of taxation;
- strict bank secrecy provisions;
- a lack of transparency in the operation of its tax system, and
- a lack of effective exchange of information with other countries.

Tax haven countries impose no tax or very low taxes in order to attract investment in their financial and other sectors. Most countries co-operate under international tax treaties by exchanging information about foreign investments. However, in tax havens, strict bank secrecy and a lack of information-exchange provisions can result in transactions and foreign investments being concealed from tax authorities.

There are legitimate reasons why a tax haven might be used, and tax administrators have no view on where Canadians invest as long as they comply with Canada's tax laws. What the CRA is concerned about are investments, transactions and schemes that use tax-haven countries to reduce, avoid, or evade Canadian tax. Using tax havens for tax avoidance and tax evasion is a growing concern for Canada as it is for other countries. The CRA is working closely with tax administrations of other countries in focusing its efforts on identifying offensive arrangements and taking corrective action.

The law in Canada

Residents of Canada, including individuals, businesses, corporations, trusts, and members of partnerships must report their worldwide income on their income tax and benefit returns, and pay the appropriate taxes on this income.

You have to report all of your income from both inside and outside Canada. Also, when completing your return, you are asked if you have foreign property with a total cost of more than CAN$100,000. If you do, you must tick "Yes," and attach a completed Form T1135, *Foreign Income Verification Statement*. Stiff penalties are imposed if the statement is not filed, is not filed correctly, or is filed late.

Generally, the CRA can go back three years and review income tax returns for individuals. However, in cases of misrepresentation or tax evasion there is no limit.

How tax havens are used

Tax havens can be used in very straightforward ways such as setting up an offshore bank account to hide assets and income with the intention of not reporting the income. This is tax evasion. Tax evasion is a deliberate attempt to conceal or distort net income. Tax evasion schemes involving tax havens may also be quite sophisticated, and take many twists and turns.

Often, tax havens are used to set up trusts or to create corporations or other entities that are used to make tracing assets as difficult as possible, including foundations designed specifically to disguise the true ownership of assets. These entities are often used as part of larger tax plans to hide critical parts of the transactions. Such plans and transactions fall under the category of aggressive tax planning and may constitute tax evasion.

Aggressive tax planning is a challenge confronting all developed countries. It can involve very complex structures with both domestic and international elements. The objective of this type of tax planning is to get tax benefits that were never intended under the normal application of the tax laws. Aggressive tax planning manipulates transactions to avoid crossing the line to tax evasion.

There are promoters who actively provide opportunities to businesses and individuals to use aggressive tax planning schemes involving tax havens to avoid their tax obligations. For example, an international promoter may offer to set up and manage offshore trusts or companies that seek to conceal a taxpayer's beneficial ownership of assets.

The following are some of the arrangements involving tax havens that the CRA is reviewing:

- **Tax shelters** – In very general terms, a tax shelter could be a gifting arrangement or an acquisition of property for which you are told that the tax benefits and deductions arising from the arrangement or the acquisition will equal or be more than the net costs of entering into the arrangement or acquiring the property. The CRA issues tax shelter identification numbers only to track shelters and participants. An identification number does not entitle you to any of the benefits related to a tax shelter. For tax shelters that involve gifting, CRA audits have determined that 96% of these arrangements make use of tax havens. The CRA audits all tax shelter arrangements. If you are considering participating in a gifting arrangement, you should review the Tax Alerts on this topic on the CRA Web site at **www.cra.gc.ca/alert**.
- **Offshore investment funds / Foreign investment entities** – Offshore investment funds and foreign investment entities are generally located in tax havens, and are used to channel investments and delay the taxation of the income earned on them. The *Income Tax Act* has anti-avoidance rules that enable the CRA to deal with this type of aggressive tax planning.
- **Health and welfare trusts** – Canadian businesses claim deductions on their tax returns for payments to fund employee health and disability plans that are primarily for the benefit of shareholders and not employees. The payments are made to trusts in tax havens.
- **Spousal trusts** – Capital gains from the sale of shares of Canadian businesses should be reported in Canada. Taxpayers try to avoid reporting these gains through the use of trusts and the emigration of trusts to tax havens, where a capital gain on disposition by the trust may be exempt by a tax treaty with Canada. This represents an abuse of the treaty when the settlor of the trust is not resident in that country.

- **Arranged loss trading schemes** – Capital losses generated by trades through brokers or agents located in tax havens are claimed by Canadian taxpayers, while offsetting capital gains are not reported.

Risks for taxpayers

Not reporting taxable income from foreign sources is against the law. When the CRA suspects non-compliance with tax laws, it takes appropriate action. The CRA will apply the provisions of the *Income Tax Act* and the *Excise Tax Act* to ensure the proper tax treatment for unreported income and undisclosed transactions. You will have to pay any provincial/territorial and federal taxes owed, plus interest and penalties. As well, a civil penalty of 50% of the federal tax otherwise payable can be applied on unreported income, plus the related provincial/territorial amounts.

In addition, if the CRA determines that you failed to report income to try to evade taxes, you could face criminal charges that may result in significant, court-imposed fines and jail time. The court-imposed fines may be up to 200% of the tax otherwise payable on the amount evaded, and jail terms may be up to five years.

The CRA publishes the names of those who have been convicted of tax evasion. Publication of the prosecution of a business for a tax offence negatively impacts clients' and other stakeholders' views of the business. As well, many business associations, boards, and other organizations maintain codes of conduct that serious tax offences would violate.

You could lose everything to an unscrupulous promoter, either through theft or if the promoter makes bad investments on your behalf. It may be difficult to get access to your funds in a foreign jurisdiction if you give up control to hide the money from the CRA. Deceitful promoters may just as easily use the secrecy laws of tax havens against you.

Over the past several years, a number of individuals have notified the CRA that they participated in tax-haven schemes and were swindled. In addition to having to pay taxes and face penalties on income that they had hidden in tax-haven countries, these individuals had their entire investments stolen outright by unscrupulous promoters, with little to no hope of recovery.

How to protect yourself

Here are some ways to protect yourself from getting caught unwittingly participating in arrangements that use tax havens to avoid paying taxes:

- Beware of any tax-haven arrangement involving secrecy and concealment. Any arrangement that involves disguised ownership, hidden income, or anonymous accounts should be treated with great caution.
- Beware of confidentiality agreements in tax arrangements that promise unusual benefits. These are a strong hint that the benefits may not stand up to legal scrutiny.
- Use common sense in considering whether what is promised is too good to be true. If the returns or tax results seem unrealistic, they probably are and you would be best advised to turn them down, or to seek independent professional advice.
- If the promoter or advisor says that they have a ruling from the CRA or legal advice, insist on seeing a copy of it. If you want to be further assured, contact your local tax services office to determine whether the arrangements would be acceptable.
- Check out the information on the CRA's Web site at **www.cra.gc.ca**. The CRA issues Tax Alerts to warn taxpayers about schemes and scams that are against the law. Some Tax Alerts describe arrangements with tax havens that the CRA is reviewing.

The CRA wants Canadians to be aware of the risks and consequences of not complying with tax laws. If you are thinking about investing in a tax-haven scheme, it's very important that you get independent legal and tax advice. Independent advice means advice from a tax professional who is not connected to the scheme or promoter.

Risks for promoters

The CRA challenges structures that are designed to avoid reporting and paying tax on world income, and will apply the full force of the law to deter tax avoidance and evasion.

Third-party civil penalties can be levied on promoters, planners, and tax preparers. These penalties are intended to deter third parties, such as promoters, from making false statements or omissions in relation to income tax or matters related to the goods and services tax / harmonized sales tax. For more information, see IC01-1, *Third Party Civil Penalties*, available on the CRA Web site at **www.cra.gc.ca**. If a case clearly involves fraudulent planning to evade taxes, criminal prosecution may also be pursued. Criminal prosecution may result in fines, jail time, or both. For example, there have been cases where promoters facilitated aggressive arrangements for taxpayers with the intent of avoiding tax where significant amounts of funds were moved offshore. In such cases, third-party penalties may be applied to the promoters. They may be assessed penalties based on an amount equivalent to 100% of their commission.

Note that there are also serious penalties for promoters who offer alleged tax advantages through arrangements that would qualify as tax shelters, but who do not get a tax shelter identification number from the CRA.

How the CRA combats the abusive use of tax havens

The CRA addresses the abusive use of tax havens on three levels: within Canada, with individual countries, and as a member of international organizations.

Within Canada

The CRA has many initiatives aimed at increasing audit and enforcement activities that detect and deter aggressive tax planning and tax evasion involving tax havens. As part of these initiatives, the CRA has taken measures to strengthen both its intelligence and technical capabilities. For example, the CRA has established 11 centres of expertise located in tax services offices across the country. These centres identify and target the arrangements of participants and promoters, and integrate this information into the CRA's risk-assessment models for compliance work. The centres bring together audit and enforcement professionals and other specialists to create teams of experts to achieve a more co-ordinated and sophisticated approach to addressing aggressive international tax planning. The work of these teams enables the CRA to continually improve its risk-assessment capability.

The CRA also receives tips and leads on known or suspected tax cheating involving tax havens. Each tip or lead is reviewed, and appropriate compliance actions are pursued.

The CRA recognizes that tax intermediaries (such as tax planners, preparers, and promoters) are an important part of the tax system, and we are enhancing our relations with them. Most tax intermediaries facilitate taxpayers' compliance with tax laws by helping them plan their tax affairs. At the same time, the CRA is aware that some intermediaries encourage non-compliance and promote aggressive tax plans and schemes involving tax havens. In such instances, the CRA uses all available enforcement tools to address those who do not comply, or who encourage others not to comply, with Canada's tax laws.

The CRA is firmly committed to preserving the integrity of Canada's tax base and is actively pursuing all cases involving the abusive use of tax havens. The CRA has increased its audit coverage for cases involving aggressive international tax planning, and has seen concrete results. For the fiscal year 2008-2009, the additional taxes identified as a result of this increased audit coverage was $738 million, more than four times the $174 million for 2005-2006.

The CRA has many initiatives underway that focus on combating aspects of the abusive use of tax havens. For example, we:

- identify promoters of aggressive tax planning schemes from information provided by treaty partners;
- identify Canadian beneficial owners of investment accounts that have been created under the names of entities located in tax havens;
- identify non-filers and non-compliant taxpayers who may be actively moving assets offshore to tax havens;
- access third-party information as it relates to offshore credit cards held by taxpayers;
- review investors who have previously participated in tax-shelter schemes; and
- are developing a systematic risk-assessment model to identify unregistered tax shelters.

Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)

FINTRAC receives, analyzes, assesses, and discloses financial intelligence on suspected money laundering, terrorist financing, and threats to the security of Canada. FINTRAC shares information with the CRA in certain circumstances. For example, FINTRAC may determine it has reasonable grounds to suspect that information would be relevant to investigating or prosecuting money laundering or terrorist activity. It would then disclose the information to the CRA if the information is also determined to be relevant to an offence of evading taxes or duties. The CRA reviews FINTRAC referrals to determine whether there are tax implications.

Tax treaties with individual countries

Information from foreign governments helps the CRA to detect and deter the concealment of income. Canada is a member of a large treaty network that shares information to deter international fiscal evasion. Tax treaties with other countries are intended to avoid situations where taxpayers have to pay tax in both Canada and the other country on the same income. They are also intended to prevent tax avoidance and evasion. Canada has a broad network of tax treaties with 87 countries that enables the CRA to obtain or share tax information on residents or businesses within those jurisdictions.

Canada will not conclude a new tax treaty, nor update an existing tax treaty, unless the treaty partner country agrees to abide by the highest international standards of tax information exchange. Canada will also invite jurisdictions that are not candidates for full-scale tax treaties to enter into bilateral tax information exchange agreements.

In Canada's 2007 federal budget, non-treaty countries were asked to agree to a tax information exchange agreement within five years of being approached by Canada to do so. If a jurisdiction agrees to a tax information exchange agreement, business income earned in the jurisdiction by foreign affiliates of Canadian firms will be exempt from Canadian tax. Otherwise, that income will be taxable in Canada as earned. Canada is in the process of negotiating tax information exchange agreements with a number of jurisdictions.

The CRA as a member of international organizations

The CRA collaborates with international organizations to identify and combat the abusive use of tax havens and other aggressive tax planning matters. International partnerships provide earlier insight into schemes that are developed abroad and marketed in Canada. Through exchanges of information, we are uncovering tax arrangements that offend the very nature of the tax system, and we are actively addressing them.

We continue to enhance international strategic partnerships, to promote effective administrative practices, and to take steps to facilitate open exchanges on problems and solutions relating to tax havens. This work is taking place in settings such as the Organisation for Economic Co-operation and Development, the Joint International Tax Shelter Information Centre, the Seven Country Tax Haven Working Group, and the Leeds Castle Group.

Organisation for Economic Co-operation and Development (OECD)

The OECD's Forum on Tax Administration was created in 1997 and encompasses 30 member countries, including Canada. Meetings are open to heads of tax administrations from all OECD countries, along with representatives from invited non-member countries and international tax organizations. The OECD also shares expertise and exchanges views with more than 100 other economies.

Joint International Tax Shelter Information Centre (JITSIC)

JITSIC is made up of representatives from the tax administrations of Australia, Canada, Japan, the United Kingdom, and the United States. The role of JITSIC is to supplement the ongoing work of tax administrations in identifying and curbing abusive tax avoidance transactions, arrangements, and schemes.

Since 2004, Canada has had almost 500 exchanges of information with JITSIC countries, involving matters such as financial products, tax shelters and offshore trusts and accounts. As collaboration between member countries continues to grow, more cross-border schemes are uncovered, shared, and addressed. In January 2009, JITSIC countries agreed to continue to expand upon their joint efforts to curb abusive tax avoidance transactions, arrangements, and schemes.

Seven Country Working Group on Tax Havens

Member countries are Australia, Canada, France, Germany, Japan, the United Kingdom and the United States. As part of the Seven Country Working Group on Tax Havens, Canada and the other countries have exchanged information on schemes concerning promoters who had an impact on more than one country. The CRA led the compilation and preparation of a report that reflects the member countries' measures to facilitate efficient identification, administration and tax legislation in respect of non-resident trusts that have resident contributors or resident beneficiaries.

The Leeds Castle Group

The Leeds Castle Group is an informal group of tax administrations whose tax commissioners meet each year to discuss means of combating aggressive tax planning, among other things. The 10 participating countries are Australia, Canada, China, France, Germany, India, Japan, South Korea, the United Kingdom, and the United States. Together these countries represent half of the world's population.

Come to us before we go to you

If you haven't reported all your income, we urge you to do so.

The CRA has a Voluntary Disclosures Program available to taxpayers who want to correct their tax affairs. If you make a full disclosure before the CRA begins any compliance or enforcement action, you may only have to pay the taxes owing plus interest, but you will not have to pay any penalties nor face prosecution in the courts. Visit **www.cra.gc.ca/voluntarydisclosures** for more information.

Do you have information on a tax haven scheme?

Let us know. Any information that could help us to identify non-compliance with our tax laws is helping protect Canada's tax system. Information can be given to us confidentially by contacting our Informant Leads Program, (whose mandate is to co-ordinate any leads that the Agency receives from taxpayers) at **www.cra.gc.ca/leads**. Please note that the CRA does not pay for information (leads). In 2007-2008, the CRA received more than 22,000 leads. All leads received by the CRA are looked at and action is taken in cases where it's warranted.

References

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Third Party Civil Penalties
IC01-1, *Third-Party Civil Penalties*
www.cra.gc.ca/E/pub/tp/ic01-1/README.html