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Marmar Penner Inc. Newsletter

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Voluntary Disclosures in Matrimonial Disputes

The Canadian income tax system allows self-employed individuals and corporations to self-assess their income and determine their income tax obligations. A small percentage of taxpayers are audited but most are assessed as filed. This honour system has permitted many business persons to accumulate wealth, assisted by the tax savings from understating their revenue or overstating their expenses. The penalties for such tax evasion can be significant, in addition to interest on both the tax and penalties.

Unreported income and false business expenses impact family law matters because adjustments need to be made for a spouse's income for support purposes and a company's maintainable earnings for business valuation purposes. If your client has unreported income or false business expenses, either personally or in a business, you should expect to encounter income tax gross-up issues when income for support is determined. You should also advise your client that he/she has breached income tax law and should make a voluntary disclosure to Canada Revenue Agency

("CRA"). The advantages of such a disclosure are magnified during a matrimonial dispute. In addition to avoiding penalties, the voluntary disclosure may do the following:

- a) Create a date of separation liability that must be shared with the other spouse by impacting the equalization payment; and
- b) Allow the offending party to go to court with "clean hands".

If the offending party is concerned that the spouse will inform CRA about reporting improprieties, then a voluntary disclosure removes the threat that the offending party has to pay 100% of the tax liabilities.

In order to make a proper voluntary disclosure, the following must be met:

- 1) The disclosure must be voluntary. This means that if CRA had already started to ask questions, it's too late;
- 2) The disclosure is complete. This means that if you confess to 50% of the actual evasion and get caught with the other 50%, you will still be subject to penalties on the whole amount of the evasion;
- 3) The disclosure involves evasion that would have been subject to a penalty; and
- 4) The disclosure includes periods that are at least one year past due. This means that, if you missed the June 15 filing deadline, you cannot make a voluntary disclosure the following month to avoid a late filing penalty.

It has been our experience that CRA is receptive to voluntary disclosures and does not subject the offending party to significant questioning in most cases. However, the party must remember that where revenues have been understated and/or expenses overstated, there will usually be an HST/GST/PST impact meaning that in addition to unpaid income taxes, there will also be sales taxes plus interest thereon.

This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper professional planning. The professionals at Marmer Penner Inc. will be pleased to assist you with any matters that arise. Please feel free to visit our website at www.marmerpenner.com.