

TAX COUNSEL

THIRD PARTY PENALTIES: FAITH, HOPE AND CCRA

There is an old adage, "good cases make bad law". The thought behind the saying is that a remedy, although just in a particular circumstance, will work injustice if universally applied. As I add my name to the long list of naysayers respecting the newly proposed third party penalties I would recommend the adage to the authors of Bill C-25.

The genesis of this Bill (given first reading in the House of Commons February 16, 2000) is a 1996 Auditor General's report that recommended penalties for promoters of abusive tax shelters. The unfortunate result will be a broadly worded law that casts a very large shadow over slick promoters and careful advisors alike.

The proposed ITA s.163.2 has two new civil penalties.

The first is a "tax planning penalty" found in subsections 163.2(2) and 163.2(3). It provides that: **"every person who makes or furnishes, participates in the making of or causes another person to make or furnish a statement 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 any other person... for a purpose of this Act is liable to a penalty..."** Where the false statement is made in respect of a planning activity or valuation activity, the penalty is the greater of \$1,000.00 and the value of the amounts the person is entitled to receive or obtain in respect of the planning activity or valuation activity.

Subsections 163.2(4) and 163.2(5) deal with the more encompassing "tax compliance penalty". This is a penalty for making or participating in the making of or assenting to or acquiescing in the making of **"a statement to, or 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 this Act..."** The penalty is the greater of \$1,000.00

and the penalty the other person would be liable for if s. 163.2 applied, i.e., 50% of the tax.

It is possible for a person to become subject to both penalties in respect of a false statement. In that event, the greater of the two penalties applies [s. 163.2(14)]

The proposed legislation defines some important terms:

1 "False statement" includes a statement that is misleading because of an omission from the statement;

2 "Culpable conduct" means conduct of commission or omission that is (a) tantamount to intentional, (b) shows indifference to compliance with the ITA, or (c) shows a wilful, reckless or wanton disregard of the law;

3 "Participate" includes (a) to cause a subordinate to act or omit information and (b) failing to take reasonable measures to prevent a subordinate committing an act or an omission of information;

4 "Excluded activity" is the promotion and selling or accepting consideration in respect of promotion and sale of flow-through shares, a tax shelter or any arrangement where one of the main purposes is to obtain a tax benefit;

5 "Planning activity" includes organizing or creating, or assisting in the organization or creation of, an entity, a plan or a scheme for participating directly or indirectly in the same;

6 "Valuation activity" means anything done by a person in determining the value of a property or service.

The broad wording of this impending legislation makes it clear that the penalties can apply to any person who has involvement in the income tax matters of another person. This includes a taxpayer's lawyer or accountant, officers, directors and employees of a corporation and the customers and suppliers of a taxpayer.

On the valuation side of things, a person

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THIRD PARTY PENALTIES (CONT'D)

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providing an opinion of value will be deemed to know that the opinion is false if the valuation varies from the fair market value by more than a prescribed amount [s.163.2(10)]. In such a case, a reverse onus will exist: the statement of opinion will be presumed false.

An advisor is afforded a defence (except for “excluded activities”) if the advisor relied in good faith on the information provided to the advisor by the other person or because of such good faith reliance failed to verify, correct or investigate the information.

If the only reason an advisor does not actually know that a statement is false is because of culpable conduct, then the advisor will be subject to the penalty. Thus if one has any reason to believe that a statement might be false, one must start asking questions. This includes satisfying oneself about the interpretation of the ITA and the application of the law and acting on that knowledge.

Consider “Notice to Reader” statements: Most Notice to Reader disclaimers state that the accountant “has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the information”. Is this an admission of culpable conduct? Can you really say you have relied in good faith on the information of a particular client when you have admitted in scores of instances that it is your routine NOT to verify accuracy or completeness?

In order to prove good faith, you will require objective evidence. That evidence may come in the form of your correspondence with your client and

notes of your meetings.

All of this information is certainly confidential and may even be privileged.

This is just a sample problem. Other possible results of the new legislation include:

- more expensive services for our clients;
- regular conflicts of interest between advisors and clients;
- charter challenges based on advisors’ rights to a defence v. clients’ rights of privilege;
- no time limits for assessment of penalties;
- no off-the-cuff opinions for clients;
- responsibility for acts of prior advisors once known.

The use of broad legislation to remedy a specific abuse or class of abuse is not sound. CCRA says never mind, we can trust them because the utilization of this legal sledgehammer will be restricted through internal policy.

Does that comfort you?

Legislative History of Bill C-25

Feb 16, 1999 - Announced in Federal Budget

Dec 7, 1999 - Ways and Means Motion

Feb 16, 2000 - First Reading in Commons

April 6, 2000 - Commencement of Second

Reading debate in Commons

TBA - Referral to Standing Committee

TBA - Third Reading in Commons



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Donald P. Mallon, BSc LLB, a partner in Prowse & Chowne, is a seasoned litigator with over 20 years of experience. Focusing on administrative and tax litigation, he draws upon his courtroom and negotiation skills to effectively represent individual and business taxpayers in disputes with Revenue Canada.



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