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Summary

The Canadian taxation regime is a self-assessment system. To ensure that taxpayers are complying with their obligations in a self-assessment system, the *Income Tax Act* provides for numerous penalties if taxpayers do not file returns on time, do not file accurately, or take actions that seek to avoid paying tax or complying with filing obligations. In this Practical Insight, **Peter Aprile, James Roberts, and Jennifer Mak, Counter Tax Litigators LLP**, comprehensively review and analyze civil penalties in the ITA. In particular, the authors (1) provide an overview of the civil non-discretionary penalties, including mandatory disclosure and the incoming GAAR penalties; (2) analyze civil discretionary penalties, including gross-negligence penalties; (3) address third-party penalties; and (4) review defences to the various penalties.

Overview

The *Income Tax Act* (ITA) sets out various penalties that apply to taxpayers, their advisors, and other individuals. These legislative penalties are Parliament's mechanism for attempting to ensure that taxpayers comply with their obligations under the ITA.

Penalties are necessary in a self-assessment tax system because the Canada Revenue Agency can review only a small percentage of tax returns to ensure accuracy and can monitor only a very few taxpayers to ensure they are filing all necessary forms and returns. In this system, penalties serve as a deterrent to taxpayers: if you do not file accurately, if you fail to file the required returns or forms, or if you file returns or forms late, you will face monetary penalties. The quantum of the penalty will vary depending on the nature of the non-compliance.

There are two main categories of penalties: civil penalties and criminal penalties. The vast majority of penalties in the ITA are civil penalties. Civil penalties are administrative penalties in that they are designed to encourage taxpayer compliance so that the Agency can enforce the ITA efficiently and effectively. Criminal penalties are penal and designed to punish taxpayers for criminal tax offences. Civil penalties and criminal penalties differ in their trial procedures, evidentiary standards, and the defences available to taxpayers. This Practical Insight addresses only civil penalties.

There are three types of civil penalties: non-discretionary penalties, discretionary penalties, and third-party penalties. Non-discretionary penalties apply when certain non-compliance occurs regardless of whether a taxpayer intended the non-compliance. Discretionary penalties apply when an Agency auditor, Agency appeals officer, or Tax Court of Canada judge determines that a taxpayer either (1) intentionally failed to comply with the ITA or (2) should have known that the taxpayer was not complying with the ITA. This type of penalty is generally referred to as a “gross-negligence penalty”. The Agency has the discretion to apply the gross-negligence penalty. Third-party penalties apply when someone other than a taxpayer is penalized for the taxpayer’s non-compliance, *e.g.*, the taxpayer’s accountant, lawyer, advisor, *etc*. Third-party penalties can also apply to individuals who do not act for or advise the taxpayer, but rather who seek to convince taxpayers to enter into certain transactions, *e.g.*, promoters of tax shelters or other transactions that require disclosure to the Agency. Some third-party penalties are non-discretionary; others are discretionary.

To identify a taxpayer’s exposure to penalties and, perhaps more importantly, to determine whether the Agency has imposed penalties in a circumstance that does not warrant penalties, it is useful to understand the following: (1) what non-compliance the penalty is designed to address; (2) what facts are necessary for the penalty to apply; (3) for discretionary penalties, what factors the Agency relies on for imposing the discretionary penalty; and (4) the possible defences to the penalty.

1. Non-Discretionary Penalties

1.1 Late-Filed or Unfiled Tax Returns

The ITA requires that individuals (including individuals who have died in the taxation year), corporations, estates, and trusts resident in Canada file a tax return each year.[1] For individuals who carry on business, the filing deadline is June 15 of the following year; for all other individuals, the filing deadline is April 30 of the following year;[2] for corporations, the filing deadline is six months after the end of the corporation’s fiscal year; and for estates and trusts, the filing deadline is 90 days after the end of the estate’s or the trust’s fiscal year.

If a taxpayer fails to file a tax return on time, subsection 162(1) of the ITA imposes a penalty. The penalty is between 5 percent and 17 percent of the unpaid tax on the late-filed return. The applicable percentage depends on how late the taxpayer files the return. Paragraph 162(1)(a) imposes a penalty equal to 5 percent of the unpaid tax as soon as the taxpayer fails to file a return by the deadline. Paragraph 162(1)(b) adds an additional penalty equal to 1 percent of the unpaid tax for each month that the tax return remains unfiled, for a maximum of 12 months.

Failure to file return of income

> 162(1) Every person who fails to file a return of income for a taxation year as and when required by subsection 150(1) is liable to a penalty equal to the total of
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> > **(a)** an amount equal to 5% of the person's tax payable under this Part for the year that was unpaid when the return was required to be filed, and
> >
> > **(b)** the product obtained when 1% of the person's tax payable under this Part for the year that was unpaid when the return was required to be filed is multiplied by the number of complete months, not exceeding 12, from the date on which the return was required to be filed to the date on which the return was filed.

The following is an example of the how the late-filing penalty applies.

> Joe Taxpayer does not carry on business and, therefore, is required to file his T1 return for the 2023 year by April 30, 2024. However, Joe files his 2023 T1 return on November 23, 2024. Subsection 162(1) imposes a penalty equal to 11 percent of Joe's tax payable on his 2022 T1 return: the initial 5 percent penalty for not filing the T1 return by April 30, 2024; plus 1 percent for each month from May to October 2024 (6 percent). There is no additional 1 percent penalty for November because Joe filed the return before the end of November.

If a taxpayer is required to file a tax return and does not file the return at all, the Agency can arbitrarily assess the taxpayer under subsection 152(7) of the ITA. If the Agency arbitrarily assesses a taxpayer, the Agency will issue a notice of assessment estimating the taxpayer's taxable income and tax payable and will impose the subsection 162(1) penalty. For this reason, the subsection 162(1) penalty applies to both late-filed and unfiled returns.

Note that because the subsection 162(1) penalty is a percentage of the unpaid tax, the penalty does not apply unless there is unpaid tax as of the filing deadline. If a taxpayer has paid the full tax liability (either by making installment payments or by having an employer make source deductions), the penalty will not apply regardless of when, or if, the taxpayer files the tax return.

Similarly, installment payments or source deductions that reduce, but do not eliminate, tax payable related to an unfiled return will reduce, but will not eliminate, the subsection 162(1) penalty. For example, if a taxpayer made installment payments of $20,000 in the year, owed $25,000 of tax for the year, and failed to file the tax return for more than 12 months after the filing deadline, the taxpayer would be subject to a 17 percent penalty only on the unpaid tax of $5,000.

However, as soon as a taxpayer fails to pay tax by the filing deadline, the subsection 162(1) penalty will apply until the taxpayer files the tax return **even if the taxpayer pays the tax liability before filing the tax return**. For example, where a taxpayer pays the tax liability in full one day after the filing deadline but does not file the tax return until more than 12 months after the filing deadline, the taxpayer will be subject to a 17 percent penalty on the full tax liability notwithstanding the payment. Conversely, if the taxpayer had made the payment on the deadline but still not filed the tax return for more than 12 months, the taxpayer would escape any subsection 162(1) penalty. The simple fact of paying the tax owed on or before the filing deadline will dictate whether the subsection 162(1) penalty applies regardless of whether the taxpayer files a tax return. This occurs because the language of subsection 162(1) provides that the penalty is calculated on the unpaid tax as of the filing deadline and, therefore, any payments after the deadline are irrelevant in the application of the penalty.

Subsection 162(1) Penalty Summary

The late-filing penalty in subsection 162(1) of the ITA is designed to provide incentive to taxpayers to file their tax returns on time. In a self-assessment system, the Agency cannot monitor all taxpayers to ensure they are filing tax returns as required under the ITA. The penalty will apply as soon as a taxpayer fails to file a tax return by the filing deadline. The tax is a percentage of the unpaid tax liability and, therefore, although the provision applies whenever a taxpayer misses a filing deadline, it has no real effect if the taxpayer has paid the tax by the filing deadline.

1.2 Repeat Late-Filed or Unfiled Tax Returns

Subsection 162(2) of the ITA provides that taxpayers who repeatedly file tax returns late (or repeatedly do not file tax returns) are subject to more significant penalties than the 5 to 17 percent of unpaid tax penalties under subsection 162(1).

The quantum of the penalty ranges from 10 percent to 50 percent of the unpaid tax on the second late-filed return. The applicable percentage depends on how late the taxpayer files the second return. Paragraph 162(2)(d) imposes a penalty equal to 10 percent of the unpaid tax as soon as the second return is late and the criteria in paragraphs 162(2)(a) to (c) are satisfied (see below for an analysis related to the criteria). Paragraph 162(2)(e) adds an additional penalty equal to 2 percent of the unpaid tax for each month that the second tax return remains unfiled, for a maximum of 20 months.

Like the penalty in subsection 162(1), the repeat-late-filing penalty in subsection 162(2) is a percentage of tax payable on the filing deadline. In these circumstances, if the taxpayer has paid the tax by the filing deadline, the penalty has no real effect.

Repeated failure to file

(2) Every person

> **(a)** who fails to file a return of income for a taxation year as and when required by subsection 150(1),
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> **(b)** to whom a demand for a return for the year has been sent under subsection 150(2), and
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> **(c)** by whom, before the time of failure, a penalty was payable under this subsection or subsection 162(1) in respect of a return of income for any of the 3 preceding taxation years

is liable to a penalty equal to the total of

> **(d)** an amount equal to 10% of the person's tax payable under this Part for the year that was unpaid when the return was required to be filed, and
>
> **(e)** the product obtained when 2% of the person's tax payable under this Part for the year that was unpaid when the return was required to be filed is multiplied by the number of complete months, not exceeding 20, from the date on which the return was required to be filed to the date on which the return was filed.

1.2.1 Necessary Criteria for the Application of the Repeat-Late-Filed Penalty

Paragraphs 162(2)(a) to (c) sets out three factual predicates for the repeat-late-filing penalty. The statute requires all three predicates or the repeat-late-filing penalty will not apply.

The first requirement, at paragraph 162(2)(a), is that the taxpayer fails to file a tax return by the filing deadline set out in subsection 150(1) of the ITA. The filing deadlines under subsection 150(1) are as follows: for individuals that carry on business, the filing deadline is June 15 of the following year; for all other individuals, the filing deadline is April 30 of the following year;[3] for corporations, the filing deadline is six months after the end of the corporation's fiscal year; and for estates and trusts, the filing deadline is 90 days after the end of the estate's or the trust's fiscal year. For example, the repeat-late-filing penalty will not apply to the 2023 taxation year unless the taxpayer failed to file the 2023 tax return by the filing deadline.

The second requirement, at paragraph 162(2)(b), is that the Agency must have sent the taxpayer a letter under subsection 150(2) of the ITA demanding that the taxpayer file the return in question. Subsection 150(2) provides that, when the Agency sends a demand to a taxpayer, the taxpayer has an obligation to file the tax return. The Agency's standard demand letter is the Agency's form TX14D. It is a computer-generated letter. Presumably, a TX14D letter is generated either (1) when the Agency's computer system identifies that a taxpayer has not filed a tax return and issues the demand or (2) an Agency employee identifies that a taxpayer has not filed a tax return and triggers the Agency's computer to issue the demand. Whichever the case, the TX14D letter does not include the name or contact information of any Agency employee or individual. Note that a letter **demanding** that a taxpayer file a tax return is different than a letter **requesting** that a taxpayer file a tax return. The Agency issues both a demand letter and a request letter. The former is a TX14D form; the latter is a TX11 form. The repeat-late-filing penalty under subsection 162(2) requires that the Agency send the taxpayer a demand letter, *i.e.*, the TX14D form, related to the tax return in question.

The third requirement, at paragraph 162(2)(c), is that the Agency must have assessed a late-filing penalty or repeat-late-filing penalty in one of the three preceding taxation years. For example, a taxpayer will only be subject to the repeat-late-filing penalty in the 2023 taxation year if the taxpayer was subject to a penalty under either subsection 162(1) or (2) in one or more of the 2020, 2021, or 2022 taxation years. In other words, if the taxpayer is subject to the late-filing penalty or the repeat-late-filing penalty in any of the previous three years, the taxpayer will be subject to the repeat-filing penalty in the subject year. Moreover, for the penalty to apply, the Agency must have assessed the previous penalty before the taxpayer late-filed the tax return in the subject year. If a taxpayer files tax returns related to several years at the same time, the repeat-late-filing penalty will not apply to any of the years.[4]

1.2.2 Defences to the Repeat-Late-Filed Penalty

The only defence to the subsection 162(2) penalty is to refute one of the three factual requirements in paragraphs 162(2)(a) to (c), *i.e.*, that the taxpayer filed the subject return on time, that the Agency did not send (or did not send properly) a TX14D demand letter, or that the taxpayer was not subject to a subsection 162(1) or (2) penalty in any of the three preceding taxation years.

Note that the Agency has the burden of proof to establish the three factual requirements.

If the Agency assesses the subsection 162(2) penalty in a circumstance in which the taxpayer did not receive the TX14D letter for the subject year, the taxpayer should file a notice of objection to dispute the imposition of the 162(2) penalty. The taxpayer should cause the Agency to provide a copy of the TX14D letter — either by accessing the Agency's files through the Access to Information and Privacy Directorate or by requesting the TX14D letter from the Agency's appeals officer assigned to review the objection. If the mailing address to which the Agency sent the TX14D is incorrect (*i.e.*, is not the taxpayer's mailing address on file with the Agency at the time the Agency sent the letter), the Agency failed to send the demand letter properly and, therefore, the repeat-late-filing penalty should not apply.

In the authors' experience, the Agency is not always able to produce a copy of the TX14D letter. If the Agency is unable to produce a copy of the TX14D letter, a taxpayer may have an argument that the Agency cannot discharge its burden of proof to support the repeat-late-filing penalty. As set out above, a TX14D demand letter is a computer-generated letter that we presume either the Agency's computer

generates on its own or an individual at the Agency causes the Agency's computer system to generate. The Agency does not always maintain a printed copy of the TX14D letter. Instead, there is a code within the Agency's internal system that records the date on which the Agency's computer issued the TX14D letter.

If a taxpayer did not receive the TX14D letter, the taxpayer can argue that the Agency has to establish that it properly sent the TX14D letter. Subsection 244(5) of the ITA provides the steps the Agency needs to take to prove that it sent the demand letter. In particular, subsection 244(5) requires that the Agency employee that generated, issued, or mailed the TX14D demand supply an affidavit confirming the same and provide a copy of the TX14D. If no Agency employee can swear an affidavit confirming the details related to generating, issuing, or mailing the TX14D letter, or if the Agency is unable to produce a copy of the TX14D letter, it is arguable that the Agency has not satisfied its burden of proof to establish that it sent a demand letter under subsection 150(2) and, therefore, the repeat-late-filing penalty should not apply.

Subsection 162(2) Penalty Summary

The repeat-late-filing penalty in subsection 162(2) of the ITA is a deterrent for taxpayers that have already failed to file returns as required under the ITA. Like the standard late-filing penalty under subsection 162(1), the tax is a percentage of the unpaid tax liability, but instead of capping at 17 percent of the unpaid tax, the repeat-late-filing penalty can be as high as 50 percent of the unpaid tax. The criteria for the application of the repeat-late-filing penalty are:

1. the taxpayer must not have filed the subject tax return on time;
2. the Agency must have sent the taxpayer a TX14D demand related to the subject taxation year; and
3. the Agency must have assessed a late-filing penalty in one of the last three taxation years.

A taxpayer's only defence against the repeat-late-filing penalty is to argue that one of the three criteria is not satisfied.

1.3 Unreported Income

The ITA does not include a provision that penalizes a taxpayer for a first-time failure to report income. In this circumstance, the Agency will often impose the late-filing penalty under subsection 162(1) of the ITA — penalizing the taxpayer 17 percent of the tax on the unreported income — for the first-time failure to report income.

However, when a taxpayer repeatedly fails to report income (*i.e.*, more than once), subsections 163(1) and (1.1) of the ITA impose a penalty. The penalty is the lesser of (1) 10 percent of the unreported income and (2) 50 percent of the tax on any unreported income provided the unreported income was not subject to source deductions.

Like all non-discretionary penalties, there is no analysis of whether the taxpayer intended to underreport income or why the failure to report occurred. Instead, provided the factual criteria in subsection 163(1) are satisfied, the penalty applies.

Repeated failure to report income

163(1) Every person is liable to a penalty who

(a) fails to report an amount, equal to or greater than $500, required to be included in computing the person's income in a return filed under section 150 for a taxation year (in this subsection and subsection (1.1) referred to as the ***unreported amount***);

(b) had failed to report an amount, equal to or greater than $500, required to be included in computing the person's income in any return filed under section 150 for any of the three preceding taxation years; and

(c) is not liable to a penalty under subsection (2) in respect of the unreported amount.

Amount of penalty

(1.1) The amount of the penalty to which the person is liable under subsection (1) is equal to the lesser of

(a) 10% of the unreported amount, and

(b) the amount determined by the formula

$$0.5 \times (A - B)$$

where

A

is the total of the amounts that would be determined under paragraphs (2)(a) to (g) if subsection (2) applied in respect of the unreported amount, and

B

is any amount deducted or withheld under subsection 153(1) that may reasonably be considered to be in respect of the unreported amount.

1.3.1 Necessary Criteria for the Application of the Unreported-Income Penalty

Paragraphs 163(1)(a) and (b) of the ITA set out the two factual requirements for the unreported-income penalty to apply. If any one of the two factual requirements does not exist, the unreported-income penalty will not apply. However, paragraph 163(1)(c) is a relieving provision that eliminates the penalty in certain circumstances even if the two factual requirements exist.

The first requirement, at paragraph 163(1)(a), is that the taxpayer fails to report at least $500 in computing the taxpayer's income for the year. Note that the $500 minimum is total income, not net income or taxable income. In other words, if a taxpayer fails to report $1,000 of revenue and $900 of expenses, this requirement is satisfied despite the fact that the taxpayer failed to report only $100 of net income.

The second requirement, at paragraph 163(1)(b), is that the taxpayer has failed to report at least $500 in computing the taxpayer's income in one of the three preceding taxation years. Again, the $500 minimum is gross amount, not the net or taxable amount.

Paragraph 163(1)(c) is the relieving provision. It provides that, if the Agency assesses the gross-negligence penalty under subsection 163(2) on the unreported income, the repeat-unreported-income penalty will not apply even if the requirements in paragraphs 163(1)(a) and (b) are satisfied. Simply put, if the Agency exercises its discretion to impose the gross-negligence penalties on the taxpayer's unreported income, the non-discretionary penalty on unreported income cannot apply.

1.3.2 Defences to the Unreported-Income Penalty

The unreported-income penalty in subsection 163(1) of the ITA is a strict-liability penalty. This means that the existence of all of the requirements triggers the application of the penalty regardless of a taxpayer's intent. The Agency has the burden of proof to establish the facts required for the imposition of the penalty.[5] However, the courts have confirmed – and the Agency has accepted – that a taxpayer can escape the unreported-income penalty if the taxpayer was duly diligent in preparing the relevant tax filings.[6] Once the Agency proves the facts to support the imposition of the penalty, the onus shifts to the taxpayer to prove that that taxpayer exercised due diligence.[7]

The Tax Court set out the due-diligence defence in *Pillar Oilfield Projects Ltd. v. R.*, when Bowman CJ held the following:

> It is, I think, contrary to ordinary concepts of fairness that a taxpayer should be penalised for a failure to observe a statutory provision or to calculate tax correctly if that taxpayer demonstrates that even with the exercise of due diligence the mistake was unavoidable.[8]

In reaching his decision, Bowman CJ relied on the Supreme Court of Canada's reasons in *R. v. Sault Ste. Marie (City)*, where Dickson J stated that offences that did not require proof of *mens rea* "may properly be called offences of strict liability"[9] and provided the following principles for the due-diligence defence to strict-liability offences:

> Offences in which there is no necessity for the prosecution to prove the existence of *mens rea*; the doing of the prohibited act *prima facie* imports the offence, leaving it open to the accused to avoid liability by proving that he took reasonable care. This involves consideration of what a reasonable man would have done in the circumstances. **The defence will be available if the accused reasonably believed in a mistaken set of facts which, if true, would render the act or omission innocent, or if he took all reasonable steps to avoid the particular event**.[10] [emphasis added]

A taxpayer can satisfy the due-diligence defence in one of two ways: (1) proving that the taxpayer "made a reasonable mistake of fact" (*i.e.*, the taxpayer was "mistaken as to a factual situation" and the mistake was reasonable) or (2) proving that the taxpayer "took reasonable precautions to avoid the event leading to the imposition of the penalty".[11]

A reasonable mistake of fact requires both a subjective and objective analysis. The taxpayer must actually believe the incorrect facts and a reasonable person in similar circumstances could have had the same mistaken belief.[12] Note that this defence is not available to a taxpayer who misunderstands the law or the taxpayer's filing obligation. The Federal Court of Appeal has confirmed that a taxpayer can only satisfy the due-diligence defence if the taxpayer takes steps to fulfil a legal duty.[13] In other words, a taxpayer that is duly diligent is one that seeks to comply with the taxpayer's obligations under the ITA and, through a mistake of fact that a reasonable person in similar circumstances would make, fails to comply with the taxpayer's obligations.

In *Galachiuk v. R.*, Galachiuk provided services to a business and received a T4A from the business. The business mistakenly did not include all amounts it paid to Galachiuk on the T4A. When filing his tax return, Galachiuk reported the amount on the T4A he had received from the business, believing that the business would include all amounts it had paid to him on the T4A. Galachiuk failed to report unrelated investment income of $517 and $638 in each of the two previous taxation years. The Agency assessed the unreported-income penalty. Galachiuk appealed and the Tax Court held that Galachiuk did not satisfy the due-diligence defence because although Galachiuk subjectively believed that the business would only issue a single T4A slip for each person and the T4A slip would include all amounts paid, a reasonable person would have reviewed the T4A slip and confirmed that it included all amounts received from the paying business.[14]

However, the Tax Court vacated the unreported-income penalty in *Galachiuk* on the basis that Galachiuk satisfied the due-diligence defence in the previous year, *i.e.*, when Galachiuk failed to report income in one of the three preceding taxation years.[15] In the previous taxation year, Galachiuk moved from Fort McMurray to Calgary. Galachiuk advised his broker and investment advisor of the move and asked them to update his address with all his investees so that he would receive all required T-slips. Knowing that there was a possibility that he still might miss some mail, Galachiuk also arranged with Canada Post to have all his mail forwarded to his new address (until one month after the deadline for issuing T-slips). Despite his efforts, Galachiuk did not receive one of the T-slips that represented a small portion of his income. Galachiuk relied on a qualified chartered accountant to prepare his returns. The Tax Court described the tax preparation process as "thorough".[16] In his testimony, Galachiuk stated that he was not aware that he did not receive the T-slip. The Tax Court found that the process that Galachiuk utilized was sufficient.

Although the Tax Court in *Galachiuk* held that a taxpayer can avoid the application of the subsection 163(1) penalty provided the taxpayer satisfies the due-diligence defence in either the subject year or the previous year, this is not settled law. Simply put, there are conflicting decisions as to whether, to avoid the unreported-income penalty, a taxpayer is required to show (1) that the taxpayer satisfied the due-diligence defence when failing to report income **in the subject year** (the restricted interpretation), or (2) that the taxpayer satisfied the due-diligence defence when failing to report income in **either the subject year or the previous year** (the expanded interpretation).

In *Galachiuk*, the Tax Court conducted an analysis to determine the proper interpretation. Ultimately, the Tax Court held that the expanded interpretation was correct on the basis that the penalty can be harsh and potentially disproportionate to the taxpayer's failure to report and if Parliament wanted to limit the circumstances in which a due-diligence defence would be available, Parliament would have expressly stated so in the legislation.[17] Further, the Tax Court determined that the defence can apply where the taxpayer showed that all reasonable precautions were taken to avoid the event leading to the imposition of the penalty in respect of either failure.[18]

The Tax Court's reasons in *Galachiuk* are sound. The authors believe that the expanded interpretation is correct. Although the Tax Court adopted the restricted approach in the 2015 post-*Galachiuk* decision *Dhanoa v. R.*[19], the Court later adopted the expanded interpretation more recently in *Greenstreet v. R*[20] and *Zhang v. R*[21], in 2019 and 2020, respectively. Therefore, while it appears the issue is not settled, the Tax Court seems to be leaning towards adopting the expanded interpretation as of recent.

Subsection 163(1) Penalty Summary

The unreported-income penalty in subsection 163(1) of the ITA provided incentive for taxpayers to report all their income. The penalty is the lesser of (1) 10 percent of the unreported amount and (2) 50 percent of the tax on any unreported income (less any tax deducted at source). The criteria for the application of the unreported-income penalty are:

1. the taxpayer must have failed to report income of $500 or more on the subject tax return;

2. the taxpayer must have failed to report income of $500 or more on a tax return in any one of the previous three taxation years; and

3. the gross-negligence penalty under subsection 163(2) of the ITA does not apply to the unreported income in question.

Defences to the unreported-income penalty are (1) arguing that one of the three criteria is not satisfied and (2) the taxpayer satisfied the due-diligence defence. A taxpayer can satisfy the due-diligence defence by establishing that the taxpayer "made a reasonable mistake of fact" or that the taxpayer "took reasonable precautions to avoid the event leading to the imposition of the penalty".[22]

1.4 Unfiled or Late-Filed Information Returns

The ITA requires that taxpayers file information returns in certain circumstances. An information return is different from a tax return. An information return discloses information to the Agency but does not calculate a tax liability, whereas a tax return generally calculates tax payable or tax remittances. The following table sets out common information returns required to be filed under the ITA.

ITA (sub)section	Form	Type of Disclosure
116(5.02)	T2062C	To disclose the acquisition of treaty-protected property from a non-resident vendor
128.1(9)	T1161	To disclose property when emigrating from Canada
149.1(14)	T3010	To disclose information related to a registered charity
233.1	T106	To disclose transactions with non-resident non-arms length persons
233.2	T1141	To disclose contributions to non-resident trusts, arrangements, or entities
233.3	T1135	To disclose foreign property the taxpayer held during a taxation year
233.4	T1134	To disclose the taxpayer's foreign affiliates
233.6	T1142	To disclose distributions from a non-resident trust
233.8	RC4649	To disclose the global income, taxes, and other information of large multinational enterprises

If a taxpayer fails to file an information return as required under the ITA, or if the taxpayer files an information return late, the taxpayer is subject to a non-discretionary penalty under subsection 162(7) of the ITA. The taxpayer may also be subject to discretionary penalties under subsections 162(10), subsection 162(10.1), and 163(2.4) of the ITA (see the section below entitled "Discretionary Penalties").

The penalty under subsection 162(7) is equal to the greater of (1) $100 and (2) $25 per day overdue for up to 100 days. In other words, the minimum penalty is $100 and will apply if the taxpayer files the information return within four days after the deadline. If the taxpayer files the return more than four days late, the penalty is $25 per day to a maximum of $2,500.

Failure to comply

(7) Every person (other than a registered charity) or partnership who fails

> **(a)** to file an information return as and when required by this Act or the regulations, or
>
> **(b)** to comply with a duty or obligation imposed by this Act or the regulations

is liable in respect of each such failure, except where another provision of this Act (other than subsection 162(10) or 162(10.1) or 163(2.22)) sets out a penalty for the failure, to a penalty equal to the greater of $100 and the product obtained when $25 is multiplied by the number of days, not exceeding 100, during which the failure continues.

Generally, the purposes of the information-reporting obligations under the ITA are (1) to allow the Agency to maintain sufficient information about Canadian residents' offshore assets to ensure that Canadian residents are paying the appropriate tax on income, gains, and imputed income from offshore sources and (2) to protect the Agency's ability to collect tax from non-residents by causing Canadian residents who engage in transactions with non-residents to withhold tax from payments to non-residents. Much of the information disclosed in the returns listed in the table above relates to offshore assets – bank accounts, investments accounts, property, and shares in non-resident corporations and non-resident trusts that are foreign affiliates — and to transactions with non-residents. The penalty in subsection 162(7) of the ITA serves as an enforcement mechanism to ensure that taxpayers comply with their information-reporting obligations.

1.4.1 Necessary Criteria for the Application of the Subsection-162(7) Penalty

Each information return has a different set of factual criteria that, when present, require a taxpayer to file the information return. It is beyond the scope of this Practical Insight to examine the factual criteria that create the obligation to file each information return. However, we will review two information returns: the T1135 information return and the T1134 information return.

T1135 Information Return

Section 233.3 requires that a taxpayer file a T1135 information return if the taxpayer owns certain offshore assets and the taxpayer's cost to acquire the specific offshore assets is CAD$100,000 or greater. Note that it is the taxpayer's **cost to acquire** the offshore assets, not the fair market value of the offshore assets, that is the first factor. Also note that it is the taxpayer's total cost of all offshore assets that must exceed CAD$100,000, not each individual asset. For example, if a taxpayer purchased two offshore properties for CAD$75,000 each, the taxpayer's offshore assets exceed the CAD$100,000 threshold and the taxpayer is required to file the T1135 if all other factual criteria are satisfied.

Certain types of properties are exempt from disclosure on the T1135 information return. If a taxpayer owns the following types of offshore properties, the taxpayer can exclude them from the T1135 information return and from the calculation of the taxpayer's cost of offshore assets:

1. a property used or held exclusively in carrying on an active business;
2. a share of the capital stock or indebtedness of a foreign affiliate;
3. an interest in a trust described in paragraph (a) or (b) of the definition of "exempt trust" in subsection 233.2(1) of the ITA;
4. a personal-use property as defined in section 54 of the ITA; and
5. an interest in, or a right to acquire, any of the above-noted excluded foreign property.[23]

Furthermore, certain taxpayers are exempt from filing the T1135 information return. Specifically, the following types of entities are not required to file a T1135 information return:

1. a mutual fund corporation or mutual fund trust;
2. a non-resident-owned investment corporation;
3. a person all of whose taxable income is exempt from Part I tax;
4. a registered investment under section 204.4 of the ITA;
5. a trust described in any of paragraphs (a) to (e.1) of the definition of trust in subsection 108(1) of the ITA;
6. a trust in which all of the persons beneficially interested are persons described above;
7. a partnership in which all the members are persons described above; and

8. a partnership where the share of the partnership's income or loss attributable to non-resident members is 90 percent or more of the income or loss of the partnership.[24]

Finally, a taxpayer is exempt from filing a T1135 information return in the first year the taxpayer becomes resident in Canada.[25]

T1134 Information Return

Section 233.4 of the ITA requires that a taxpayer file a T1134 information return to report the taxpayer's foreign affiliates and controlled foreign affiliates. The terms "foreign affiliate" and "controlled foreign affiliate" are defined in the ITA in subsection 95(1). Moreover, section 94.2 of the ITA deems certain non-residents to be corporations for the purposes of the foreign affiliate and controlled foreign affiliate definitions. The definitions are complex. It is beyond the scope of this Practical Insight to analyze the relevant definitions and set out what constitutes a foreign affiliate or a controlled foreign affiliate.

Instead, we propose to identify two administrative exemptions to filing a T1134 information return. The two exemptions, if applicable, relieve taxpayers who have foreign affiliates or controlled foreign affiliates from filing T1134 information returns.

The first exemption we refer to as the "indirect-foreign-affiliate exemption". Simply put, it provides that a taxpayer is not required to file a T1134 information return related to a foreign affiliate of the taxpayer **unless the taxpayer or a controlled foreign affiliate of the taxpayer** directly owns shares in the foreign affiliate.[26] In other words, if the taxpayer does not own shares in the foreign affiliate directly, and a controlled foreign affiliate of the taxpayer does not own shares in the foreign affiliate directly, the taxpayer does not have an obligation to file a T1134 form related to the foreign affiliate.

The second exemption we refer to as the "dormant-or-inactive exemption". A taxpayer is not required to file a T1134 information return for a foreign affiliate (or controlled foreign affiliate) if all three of the following criteria are satisfied:

1. the foreign affiliate's gross receipts in the year were less than CAD$25,000,

2. the fair market value of the foreign affiliate's assets in the year was less than CAD$1,000,000, and

3. the Canadian taxpayer's total cost amount in the year related to the interests in **all the taxpayer's foreign affiliates** was less than $100,000.[27]

The Agency has interpreted the phrase "gross receipts" to mean all transactions, not just income. If a foreign affiliate does not earn any income in the year but receives a loan in excess of CAD$25,000 in the year, the Agency will not consider the foreign affiliate to satisfy the dormant-or-inactive exemption.

Both the indirect-foreign-affiliate exemption and the dormant-or-inactive exemption are administrative exemptions that the Agency has established and are not legislative exemptions.

1.4.2 Defences to the Subsection-162(7) Penalty

The first defence to a penalty for late filing or failing to file an information form is that a taxpayer does not meet the factual preconditions necessary to warrant filing an information form.

The second defence to the penalty is to determine whether an exemption applies to relieve the taxpayer's filing obligation, such as the indirect-foreign-affiliate exemption and the dormant-or-inactive exemption to the T1134 information form.

The third defence is a statutory due-diligence defence that is available for some information returns. The ITA, at section 233.5, specifically provides a due-diligence exception to penalties for failing to file forms under sections 233.2 to 233.4: disclosing contributions to non-resident trusts, disclosing foreign assets, and disclosing foreign affiliates.

Due-Diligence Exception

233.5 The information required in a return filed under section 233.2 or 233.4 does not include information that is not available, on the day on which the return is filed, to the person or partnership required to file the return where

> **(a)** there is a reasonable disclosure in the return of the unavailability of the information;
>
> **(b)** before that day, the person or partnership exercised due diligence in attempting to obtain the information;
>
> **(c)** if the return is required to be filed under section 233.2 in respect of a trust, at the time of each transaction, if any, entered into by the person or partnership after March 5, 1996 and before June 23, 2000 that gave rise to the requirement to file a return for a taxation year of the trust that ended before 2007 or that affects the information to be reported in the return, it was reasonable to expect that sufficient information would be available to the person or partnership to comply with section 233.2 in respect of each taxation year of the trust that ended before 2007;

> **(c.1)** if the return is required to be filed under section 233.2, at the time of each contribution (determined with reference to subsection 233.2(2)) made by the person or partnership after June 22, 2000 that gives rise to the requirement to file the return or that affects the information to be reported in the return, it was reasonable to expect that sufficient information would be available to the person or partnership to comply with section 233.2;
>
> **(c.2)** if the return is required to be filed under section 233.4 by a person or partnership in respect of a corporation that is a controlled foreign affiliate for the purpose of that section of the person or partnership, at the time of each transaction, if any, entered into by the person or partnership after March 5, 1996 that gives rise to the requirement to file the return or that affects the information to be reported in the return, it was reasonable to expect that sufficient information would be available to the person or partnership to comply with section 233.4; and
>
> **(d)** if the information subsequently becomes available to the person or partnership, it is filed with the Minister not more than 90 days after it becomes so available.

The Tax Court of Canada has held that the common law due-diligence defence is also available to refute penalties under subsection 162(7). Specifically, in *Douglas v. R.*, the Tax Court held that "[a]lthough the penalty in subsection 162(7) is strict and Parliament has not provided for a due diligence defence, this Court has held that even strict penalties should not be applied if a taxpayer has taken all reasonable measures to comply with the legislation .... It has been my view that the judge-made due diligence defence should be applied sparingly. However, this is an appropriate case in which it should be applied."[28]

1.4.3 Additional Information Returns

Several other provisions provide for similar types of penalties for late filing or failing to file other forms and for making minor errors, omissions, or misstatements on information returns. The table below sets out the additional provision that are non-discretionary penalties and the circumstances in which they apply.[29]

ITA subsection	Penalty	Amount
Subsection 162(4)	Failure to complete or deliver an ownership certificate.	$50 per failure.
Subsection 162(5)	Failure to provide information on an information return.	$100 per failure.

Subsection 162(6)	Failure to provide an identification number (SIN or business number) to a person required to make an information return requiring the number.	$100 per failure.
Subsection 162(7.1)	Failure of a member of a partnership to file an information return as required under the ITA.	$25 for each day of default. Minimum of $100. Maximum of $2,500.
Subsection 162(8)	Repeated failure of a partnership to file an information return where the partnership was previously assessed the penalty under subsection 162(7.1) in respect of one of its three preceding fiscal periods.	$100 per member of the partnership for each month or part of a month during which the failure to file continues. Maximum of $2,400 per partner.

1.5 Excess Capital Dividend Election

A capital dividend account is a notional account that records funds that a corporation can distribute to shareholders on a tax-free basis. Generally speaking, it includes the non-taxable portion of capital gains, proceeds received under insurance policies, capital dividends the corporation received, and other non-taxable receipts.

Subsection 83(2) of the ITA provides that a corporation can elect to treat any dividend as a capital dividend. When a corporation elects to treat a dividend as a capital dividend, the corporation is required to prepare and file certain forms to support the capital dividend election.[30]

If a corporation elects to treat a dividend as a capital dividend and the amount of the dividend exceeds the corporation's capital dividend balance, then the ITA, at subsection 184(2), imposes an additional tax. In particular, the additional tax is equal to 60 percent of the excess election. Subsection 185(4) provides that the corporation and the dividend recipient are jointly and severally liable for the additional tax.[31]

When the Agency identifies that a corporation elected a capital dividend in excess of the capital dividend amount, the Agency will issue a notice of assessment to impose the 60 percent tax on the excess. However, under subsection 184(3), the corporation can, within 90 days of the penalty assessment, elect to treat the excess as a separate dividend, *i.e.*, as a taxable dividend.

This allows the corporation and the dividend recipient to avoid the 60 percent additional tax for the excess election. Instead, the dividend recipient will pay tax on the excess dividend. To accomplish this, the corporation must file an election containing the information prescribed in Regulation 2106 of the ITA.[32]

Note that, if the corporation misses the 90-day deadline to file the election to treat the excess as a taxable dividend, then the corporation can apply to the Agency that the Agency accept a late-filed election. The Agency has the discretion, under subsection 220(3.2) of the ITA and the Agency's Taxpayer Relief Program, to accept a late-filed election to treat the excess as a taxable dividend.

1.6 Failure to Withhold and Remit Payroll Deductions

Subsections 227(8) and (9) of the ITA provide that, when a taxpayer has an obligation to withhold and remit tax to the Agency on another person's behalf before a certain date, and the taxpayer fails to comply with this obligation, the taxpayer is subject to penalties. The wording of the penalties is similar, but subsections 227(8) and (9) contain two distinct penalties that apply in two distinct circumstances.[33] The subsection 227(8) penalty applies where the taxpayer failed to withhold the tax on the other person's behalf. The subsection 227(9) penalty applies when the taxpayer withheld tax on the other person's behalf but did not remit it to the Agency. The penalties are mutually exclusive.

The deadline for remitting the tax withheld varies depending on the taxpayer's remitting frequency. The chart below is reproduced from the Agency's website related to how and when to remit source deductions.[34]

Remitting Frequency, Periods and Due Dates by Remitter Type			
Remitter Type	**Remitting Frequency**	**Remitting Period**	**Remittance Due Dates**
Quarterly	Quarterly	January 1 to March 31 April 1 to June 30 July 1 to September 30 October 1 to December 31	April 15 July 15 October 15 January 15
Regular	Monthly	Calendar Months	15th day of the next month
Threshold 1 Accelerated	Up to twice a month	1st to 15th day of the month 16th to end of the month	25th day of same month 10th day of the next month
Threshold 2 Accelerated	Up to four times a month	1st to 7th day of the month 8th to 14th day of the month 15th to 21st day of the month 22nd to end of the month	3 working day after the 7th 3 working day after the 14th 3 working day after the 21st 3 working day after the last day of the month

1.6.1 Subsection 227(8) Penalty – Failure to Withhold

> 227(8) Subject to subsection (9.5), every person who in a calendar year has failed to deduct or withhold any amount as required by subsection 153(1) or section 215 is liable to a penalty of
>
> **(a)** 10% of the amount that should have been deducted or withheld; or
>
> **(b)** where at the time of the failure a penalty under this subsection was payable by the person in respect of an amount that should have been deducted or withheld during the year and the failure was made knowingly or under circumstances amounting to gross negligence, 20% of that amount.

The subsection-227(8) penalty is either 10 percent or 20 percent of the amount not withheld. A taxpayer's first failure to withhold in a taxation year is subject to a penalty equal to 10 percent of the amount not withheld. The penalty increases to 20 percent of the amount not withheld for each successive failure to withhold in the same taxation year. Also, the 20 percent applies to all failures — including the first failure in the taxation year — if the Agency determines that the taxpayer failed to withhold tax on the person's behalf intentionally or under circumstances amounting to gross negligence. In other words, the 20 percent penalty is both non-discretionary (for the second and further failures to withhold in the same taxation year) and discretionary (if the Agency determines that the taxpayer was grossly negligent).

Note that, if a taxpayer has several businesses or other entities that require the taxpayer to withhold amounts on behalf of others, subsection 227(9.5) deems each separate business or entity to be a separate person for the purpose of the failure-to-withhold penalty. The effect is that the increased penalty under paragraph 227(8)(b) will only apply where the first penalty was in respect of the same business.[35]

The Federal Court of Appeal has determined that the paragraph-227(8)(a) penalty is a strict liability penalty[36] and, therefore, the taxpayer can advance a due-diligence defence to dispute the application of the penalty.[37]

1.6.2 Subsection 227(9) Penalty – Failure to Remit

> 227(9) Subject to subsection 227(9.5), every person who in a calendar year has failed to remit or pay as and when required by this Act or a regulation an amount deducted or withheld as required by this Act or a regulation or an amount of tax that the person is, by section 116 or by a regulation made under subsection 215(4), required to pay is liable to a penalty of
>
> (a) subject to paragraph (b), if

(i) the Receiver General receives that amount on or before the day it was due, but that amount is not paid in the manner required, 3% of that amount,

(ii) the Receiver General receives that amount

(A) no more than three days after it was due, 3% of that amount,

(B) more than three days and no more than five days after it was due, 5% of that amount, or

(C) more than five days and no more than seven days after it was due, 7% of that amount, or

(iii) that amount is not paid or remitted on or before the seventh day after it was due, 10% of that amount; or

(b) where at the time of the failure a penalty under this subsection was payable by the person in respect of an amount that should have been remitted or paid during the year and the failure was made knowingly or under circumstances amounting to gross negligence, 20% of that amount.

The subsection 227(9) penalty applies when the taxpayer withheld tax on the other person's behalf but did not remit it to the Agency. Similar to the subsection 227(8) penalty, subsection 227(9) provides a smaller penalty for a first-time failure to remit in a taxation year, followed by a larger penalty for second and further failures. It also provides that the Agency can impose the larger penalty if the Agency determines that the taxpayer intentionally failed to remit or was grossly negligent in its failure.

The penalty for a first-time failure to remit in a taxation year is on an escalating scale, increasing in lockstep with the number of days that the taxpayer's failure to remit continues. It is important to note that the penalty is calculated to the date that the Agency **receives** the remittance, not the day the taxpayer sends the remittance. If the Agency receives the remittance one to three days late, the penalty is 3 percent of the remittance; if the Agency receives the remittance four or five days late, the penalty is 5 percent of the remittance; if the Agency receives the remittance six or seven days late, the penalty is 7 percent of the remittance; if the Agency receives the remittance more than seven days late, the penalty is 10 percent of the remittance.

The higher penalty in paragraph 227(9)(b) applies in the same circumstances as those set out in paragraph 227(8)(b), but for a failure to remit, *i.e.*, the penalty increases to 20 percent of the amount not remitted for each successive failure to remit in the same taxation year. Note that, if a taxpayer has several businesses or other entities that require the taxpayer to withhold amounts on behalf of others, subsection 227(9.5) deems each separate business or entity to be a separate person for the purpose of the failure-to-remit penalty. The effect is that the increased penalty under paragraph 227(9)(b) will only apply where the first penalty was in respect of the same business.[38]

The paragraph-227(9)(a) penalty is a strict liability penalty and, therefore, the taxpayer can advance a due-diligence defence to dispute the application of the penalty.[39]

The ITA, at subsection 227(9.1), provides a *de minimis* threshold for application of the failure-to-remit penalty under subsection 227(9). Except in the case where a person acts knowingly or under circumstances amounting to gross negligence, the penalty will only be applied to the delay or failure to remit the full amount when the remittance amount is over $500.

1.7 General Anti-Avoidance Rule Penalties

Section 245 of the ITA sets out the general anti-avoidance rule (GAAR), which provides the Minister with broad powers to deny a tax benefit that may technically satisfy the provisions of the ITA, but ultimately undermine and abuse a provision's object, spirit, and purpose. In the March 2023 budget, the Department of Finance proposed substantial changes to the GAAR.[40]

Among the many significant amendments to the GAAR, the Minister of Finance proposed Bill C-59 to impose a considerable penalty on taxpayers whose transactions are denied by the GAAR. By enacting these penalties, the Minister of Finance aims to impose a significant deterrent on abusive tax planning.

On June 20, 2024, Bill C-59 received royal assent.

1.7.1 GAAR Penalties

The new subsection 245(2.1) introduces an automatic penalty equal to 25% of the amount of the tax benefit (other than a tax benefit arising from the creation of unutilized tax attributes) denied due to the application of the GAAR, less any gross-negligence penalties imposed in respect of the same transaction or series of transactions.[41]

The 25% GAAR penalty is automatically applied, as evidenced by the statutory wording in subsection 245(2.1) "…the person **is liable to a penalty** for the taxation year equal to the amount…" [emphasis added]. And, the penalty only applies to the tax benefit and not to any interest accrued on unpaid tax after the application of subsection 245(2).

Note that when applying the GAAR, the Minister has burden to establish the avoidance transactions are abusive and frustrate (misuse or abuse) the object, spirit and purpose of the provisions of the Act.[42] Therefore, the GAAR penalties will only be valid if the Minister can prove this on a balance of probabilities.

The GAAR penalties apply to transactions occurring on or after June 20, 2024.[43] Bill-C59 also introduced new legislation to extend the normal reassessment period by three years for transactions that have been assessed due to the application of the GAAR.

Penalty

(5.1) If subsection (2) applies to determine the tax consequences to a person for a taxation year in respect of a transaction that was not disclosed by the person to the Minister in accordance with section 237.3 or 237.4, the person is liable to a penalty for the taxation year equal to the amount determined by the formula

$$(A + B) \times 25\% - C$$

where

A

is the amount by which the tax payable by the person under this Act for the year exceeds the amount that would have been payable by the person under this Act for the year if subsection (2) had not applied in respect of the transaction;

B

is the amount by which the total of all amounts, each of which is an amount that would have been deemed to be paid on account of the person's tax payable under Part I for the year if subsection (2) had not applied in respect of the transaction, exceeds the total of all amounts that are deemed to be paid on account of the person's tax payable under Part I for the year; and

C

is the amount of any penalty payable by the person under subsection 163(2), to the extent that the amount is in respect of the transaction or a series that includes the transaction and did not reduce the penalty payable by the person under this subsection in a preceding taxation year.

1.7.2 Defences to the Subsection 245(5.1) GAAR Penalty

The first defence to the new GAAR penalty is the taxpayer's disclosure of the transaction in which the GAAR applied. If the taxpayer disclosed (either mandatorily or voluntarily) the transaction that is subject to the GAAR under the reportable transaction rules in section 237.3 or notifiable transactions in section 237.4 of the ITA, then the penalty will not apply.[44]

The second defence to the penalty is a statutory due-diligence defence set out in the new subsection 245(5.2). The taxpayer will not be subject to a GAAR penalty if they can demonstrate that it would have been reasonable to conclude that a transaction or series would not be subject to the GAAR at the time it was entered into because of the taxpayer's reliance on an identical or almost identical transaction or series that was the subject of

1. the Minister's published administrative guidance or statements or another relevant government authority, or

2. one or more court decisions.[45]

The Explanatory Notes explain that "[t]he 'identical or almost identical' threshold is quite high and, as a result, using the same tax strategy or entering into a transaction that is merely similar would not be enough to qualify for the exclusion".[46] Since the due-diligence test is applied at the time the transaction was entered into, it could be relied upon even where there are subsequent changes in the Agency's administrative position or jurisprudence.[47]

Penalty — exception

(5.2) Subsection (5.1) does not apply to a person in respect of a transaction if the person demonstrates that, at the time that the transaction was entered into, it was reasonable for the person to have concluded that subsection (2) would not apply to the transaction in reliance on the transaction or a series that includes the transaction being identical or almost identical to a transaction or series that was the subject of

(a) published administrative guidance or statements made by the Minister or another relevant governmental authority; or

(b) one or more court decisions.

1.8 Penalties Related to the Mandatory Disclosure Rules

In June 2023, Parliament introduced new legislation, expanding the "mandatory disclosure rules" in the ITA by

1. broadening the existing "reportable transactions" rules in section 237.3;[48]
2. creating a new category of "notifiable transactions";[49]
3. requiring certain corporations to report "uncertain tax treatments";[50]
4. extending the normal reassessment period where there is non-compliance with reporting rules;[51] and
5. expanding penalties for non-compliance with reporting rules.[52]

The penalties for non-compliance with reporting (1) "reportable transactions", (2) "notifiable transactions", and (3) "uncertain tax treatments" are discussed below.

1.8.1 Reportable Transactions

Under section 237.3 of the ITA, a transaction is a "reportable transaction" when it meets the following criteria:

1. the transaction is an “avoidance transaction” or part of a series of transactions that includes an “avoidance transaction” entered into by or for the tax benefit of a person. An “avoidance transaction” is a transaction where it can reasonably be concluded that one of the main purposes of entering into the transaction or series of transactions is to obtain a tax benefit; and

2. the transaction or series of transactions has at least one of three following generic hallmarks (i.e., features the Minister believes often accompany aggressive tax planning):

    a. contingent fee arrangements – This criterion is met when a promoter (a person who promotes or sells a tax arrangement) or tax advisor is entitled to contingent fees in respect of the transaction or series of transactions based on the tax benefits obtained or the number of taxpayers who participate in or receive advice about the transaction or series;

    b. confidential protection – This criterion is met when the promoter or advisor for the transaction obtains an agreement that prohibits the participant from disclosing the details or structure of the transaction to any person) in respect of the avoidance transaction or series; or

    c. contractual protection – This criterion is met when the taxpayer, the person who entered into the transaction on behalf of the taxpayer, or the promoter or advisor have or had any form of protection against failure of the transaction or that pays for any expense, including tax, interest, penalties, or a similar amounts, that may be incurred during a dispute about the tax benefit in respect of the transaction in respect of the avoidance transaction or series. This does not include standard representations, warranties, and guarantees between a vendor and purchaser; standard price adjustment clauses; and contractual protection involving insurance essential to a business sale agreement between independent parties, aimed at adjusting the purchase price for pre-existing liabilities and primarily serving non-tax-related purposes.[53]

The following parties must report a “reportable transaction” by filing Form RC312 within 90 days of the earlier of (1) the day the taxpayer becomes contractually obligated to enter into the transaction; and (2) the day the taxpayer enters into the transaction:

1. a person receiving (or expecting to receive) the tax benefit from the reportable transaction;
2. a person entering into a reportable transaction for the benefit of someone receiving a tax benefit;
3. advisors and promoters who receive certain fees in connection with reportable transactions; and
4. a person who did not deal at arm’s length with an advisor or promoter and who is entitled to receive certain types of fees in connection with reportable transactions.[54]

The amended reportable transaction rules in section 237.3 of the Act apply with respect to reportable transactions entered into after June 21, 2023 and to reportable transactions that “straddle” this date. For example, if a person contracted to enter into a reportable transaction on June 1, 2023, but did not enter the relevant transaction until June 30, the reporting obligation will apply, and the 90-day reporting period will begin on June 30, 2023.

1.8.2 Notifiable Transactions

Section 237.4 sets out the notifiable transaction scheme, requiring certain parties to file information returns when they enter into a "notifiable transaction" (or series of transactions that includes a "notifiable transaction") that creates a tax benefit.

A transaction is a "notifiable transaction" when it is the same or substantially similar to a transaction that the Minister of National Revenue has designated as a notifiable transaction. .

As of November 2023, the Minister of Finance has designated six types of notifiable transactions:[55]

a. straddle loss creation transactions using a partnership;
b. avoidance of deemed disposal of trust property;
c. manipulation of bankrupt status to reduce a forgiven amount in respect of a commercial obligation;
d. reliance on purpose tests in section 256.1 to avoid a deemed acquisition of control; and
e. certain back-to-back arrangements avoiding the thin capitalization rules or non-resident withholding tax.

Similarly, the following parties must report a "notifiable transaction" by filing Form RC312 within 90 days of the earlier of (1) the day the taxpayer becomes contractually obligated to enter into the transaction; and (2) the day the taxpayer enters into the transaction:

1. a person receiving (or expecting to receive) the tax benefit from the reportable transaction;
2. a person entering into a reportable transaction for the benefit of someone receiving a tax benefit;
3. advisors and promoters who receive certain fees in connection with reportable transactions; and
4. a person who did not deal at arm's length with an advisor or promoter and who is entitled to receive certain types of fees in connection with reportable transactions.[56]

The notifiable transaction rules in section 237.4 of the Act apply with respect to reportable transactions entered into after June 21, 2023 and to notifiable transactions that "straddle" this date.

1.8.3 Uncertain Tax Treatments (Reporting Corporations)

The last requirement in Parliament's new enhanced mandatory disclosure rules is for "reporting corporations" to disclose uncertain tax treatments.

A "reporting corporation" is a corporation that[57]

1. has relevant financial statements for the year (i.e., audited financial statements in accordance with IFRS or another country-specific generally accepted accounting principles);
2. has at least $50 million in the carrying value of assets at the end of the year; and
3. is required to file a Canadian tax return.

Reporting corporations are required to file an information return (Form RC3133) where there is uncertainty about income tax treatment reflected on their audited financial statements.

Uncertain tax treatments must be reported on or before the reporting corporation's regular tax filing deadline and applies to tax years beginning after 2022.[58]

1.8.5 Mandatory Disclosure Rules Penalties

The new enhanced mandatory disclosure rules introduce penalties for failing to file information returns related to reportable or notifiable transactions and uncertain tax treatment. The failure to file penalties are summarized as follows:

	Failure to File Reportable or Notifiable Transactions (Corporations with $50 million or greater in assets)	**Failure to File Reportable or Notifiable Transactions (All other taxpayers)**	**Failure to File Uncertain Tax Treatment**
Taxpayer	**Weekly Penalty**: $2,000 per week **Maximum Penalty**: Greater of a. $100,000 and b. 25% of the tax benefit	**Weekly Penalty**: $500 per week **Maximum Penalty**: Greater of a. $25,000 and b. 25% of the tax benefit	**Weekly Penalty**: $2,000 per week for each position **Maximum Penalty**: $100,000 for each position

The following are three examples of how the failure to file reportable or notifiable transactions penalties apply:

> A Inc. is a corporation with $50 million in assets. It entered into a reportable or notifiable transaction on August 1. It received a tax benefit of $1,000,000. A Inc. did not report the transaction within 90 days (October 30). On December 1 (i.e., 4 weeks late), it reported the transaction to the Canada Revenue Agency. A Inc. is liable for a penalty of $8,000 ($2,000 per week x 4 weeks).
>
> Joe Taxpayer entered into a reportable or notifiable transaction on August 1. He received $20,000 in tax benefits from the transaction. He did not report the transaction within 90 days (October 30). On March 1 (i.e., 17 weeks late), he reported the transaction to the Canada Revenue Agency. He is liable for a penalty of $8,500 ($500 per week x 17 weeks).

B Inc. is a reporting corporation that meets the definition of subsection 237.5(1). On June 30 (i.e., B Inc.'s regular tax filing deadline), it did not report an uncertain tax treatment from its previous December 31 year-end audited financial statements. On September 1 (i.e., 8 weeks late), it reported the uncertain tax treatment to the Canada Revenue Agency. B Inc. is liable for a penalty of $16,000 ($2,000 per week x 8 weeks).

There is no limitation period with respect to the Agency's discretion to impose the mandatory disclosure failure to file penalties. In other words, the Agency can issue an assessment imposing the mandatory disclosure penalty at any time.[59]

The new mandatory disclosure rules also introduce penalties for advisors and promoters who fail to file the required information returns related to reportable and notifiable transactions. These penalties are detailed in section 3.3 below.

Penalty – Reportable Transactions

237.3 (8) Every person who fails to file an information return in respect of a reportable transaction as required under subsection (2) on or before the day required under subsection (5) is liable to a penalty equal to

(a) if the person is described in paragraph (2)(a) or (b),

(i) if the person is a corporation and the carrying value of the corporation's assets is greater than or equal to $50 million for its last taxation year that ends prior to the day on which the information return is required to be filed under subsection (5), $2,000 multiplied by the number of weeks during which the failure continues, to a maximum amount equal to the greater of

(A) $100,000, and

(B) 25% of the amount of the tax benefit in respect of the reportable transaction, and

(ii) in any other case, $500 multiplied by the number of weeks during which the failure continues, to a maximum amount equal to the greater of

(A) $25,000, and

(B) 25% of the amount of the tax benefit in respect of the reportable transaction; and

(b) if the person is described in paragraph (2)(c) or (d), the total of

(i) the amount of the fees charged by that person in respect of the reportable transaction,

(ii) $10,000, and

(iii) $1,000 multiplied by the number of days during which the failure continues, up to a maximum of $100,000.

Penalty – deeming rule

(8.1) If a person described in both paragraphs (2)(b) and (d) is liable to a penalty under subsection (8) in respect of a reportable transaction, the amount of the penalty is deemed to be equal to the greater of the amounts determined under paragraphs (8)(a) and (b).

Penalty – Notifiable Transactions

237.4 (12) Every person who fails to file an information return in respect of a notifiable transaction as required under subsection (4) on or before the particular day required under subsection (9) is liable to a penalty equal to

(a) if the person is described in paragraph (4)(a) or (b),

(i) if the person is a corporation and the carrying value of the corporation's assets is greater than or equal to $50 million for its last taxation year that ends prior to the day on which the information return is required to be filed under subsection (4), $2,000 multiplied by the number of weeks during which the failure continues, to a maximum amount equal to the greater of

(A) $100,000, and

(B) 25% of the amount of the tax benefit in respect of the notifiable transaction, and

(ii) in any other case, $500 multiplied by the number of weeks during which the failure continues, to a maximum amount equal to the greater of

(A) $25,000, and

(B) 25% of the amount of the tax benefit in respect of the notifiable transaction; and

(b) if the person is described in paragraph (4)(c) or (d), the total of

(i) the amount of the fees charged by that person in respect of the notifiable transaction,

(ii) $10,000, and

(iii) $1,000 multiplied by the number of days during which the failure continues, up to a maximum of $100,000.

Penalty – deeming rule

(13) If a person described in both paragraphs (4)(b) and (d) is liable to a penalty under subsection (12) in respect of a notifiable transaction, the amount of the penalty is deemed to be equal to the greater of the amounts determined under paragraphs (12)(a) and (b).

Penalty – non-application

(14) For greater certainty, if any person is deemed to have filed an information return in prescribed form and manner in respect of a particular notifiable transaction under subsection (5), that person is not liable to a penalty under subsection (12) in respect of the particular transaction.

Penalty – Reportable Uncertain Tax Treatment

237.5 (5) Every corporation that fails to report a reportable uncertain tax treatment on an information return as required under subsection (2) on or before the day required under subsection (3) is liable to a penalty, for each such failure to report, equal to $2,000 multiplied by the number of weeks during which the failure continues, up to a maximum of $100,000.

1.8.6 Defences to the Mandatory Disclosure Rules Penalties

The ITA provides a due diligence defence to the late filing penalties related to reportable transactions, notifiable transactions, and reporting uncertain tax treatments.

Subsection 237.3(11) provides that a person required to file an information return in respect of a reportable transaction is not liable for the failure to file penalty if the person exercised the degree of care, diligence, and skill to prevent the failure to file that a reasonably prudent person would have exercised in comparable circumstances

Similarly, subsection 237.4(6) provides that the penalty does not apply to taxpayers or persons who enter into notifiable transactions to benefit a taxpayer where the taxpayer or person has exercised the degree of care, diligence and skill in determining whether the transaction is a notifiable transaction that a reasonably prudent person would have exercised in comparable circumstances.

The Agency's guidance on notifiable transactions clarifies that a person who obtained the tax benefit would generally meet their due diligence obligations by asking their advisors about potential reporting obligations that might arise from the transactions (and being informed by their advisors that no such reporting obligations will arise on account of the transaction being a notifiable transaction or substantially similar to a notifiable transaction).[60]

Similary, subsection 237.5(6) provides a similar due diligence defence for corporations required to file an information return in respect of a reportable uncertain tax treatment if the corporation has exercised the degree of care, diligence, and skill to prevent the failure to file that a reasonably prudent person would have exercised in comparable circumstances.

For the due diligence defence to apply for reportable transactions, notifiable transactions, and uncertain tax treatments, one must show diligence to *prevent* the failure to report. In other words, actions to show actions taken after the failure are not enough to meet the due diligence test.

At the time of writing, there is no case law surrounding the interpretation of the due diligence defence for these provisions. However, the language is the same as the director's liability due diligence defence set out in subsection 227.1(3), which has been extensively discussed and litigated at the Tax Court of Canada and the Federal Court of Appeal. The principles and guidance set out by the Courts should apply equally to the due diligence defences set out in subsections 237.3(11), 237.4(6), and 237.5(6).

Lastly, taxpayers are not required to file information returns related to reportable transactions and notifiable transactions if it is reasonable to believe that the information is subject to solicitor-client privilege.[61] In addition, the information return requirements do not apply to a person solely because the person provided clerical services or secretarial services with respect to a reportable or notifiable transaction.[62]

A due diligence defence is also available for advisors and promoters who may be liable for failure to file penalties related to reportable transactions. This due diligence defence is detailed in section 3.3.1 below.

Due diligence – Reportable Transactions

237.3 (11) A person required to file an information return in respect of a reportable transaction is not liable for a penalty under subsection (8) if the person has exercised the degree of care, diligence and skill to prevent the failure to file that a reasonably prudent person would have exercised in comparable circumstances.

Clerical or secretarial services

(4) For greater certainty, subsection (2) does not apply to a person solely because the person provided clerical services or secretarial services with respect to a reportable transaction.

Solicitor-client privilege

(17) For greater certainty, this section does not require the disclosure of information if it is reasonable to believe that the information is subject to solicitor-client privilege.

Due diligence – Notifiable Transactions

237.4 (6) Paragraphs (4)(a) and (b) do not apply to a person in respect of a notifiable transaction if the person has exercised the degree of care, diligence and skill in determining whether the transaction is a notifiable transaction that a reasonably prudent person would have exercised in comparable circumstances

Clerical or secretarial services

(8) For greater certainty, subsection (4) does not apply to a person solely because the person provided clerical services or secretarial services with respect to the notifiable transaction.

Solicitor-client privilege

(18) For greater certainty, this section does not require the disclosure of information if it is reasonable to believe that the information is subject to solicitor-client privilege.

Due diligence – Uncertain Tax Treatment

237.5 (6) A corporation required to file an information return in respect of a reportable uncertain tax treatment is not liable for a penalty under subsection (5) if the corporation has exercised the degree of care, diligence and skill to prevent the failure to file that a reasonably prudent person would have exercised in comparable circumstances.

2. Discretionary Penalties

The ITA provides for larger penalties in circumstances where the taxpayer intentionally failed to comply with the ITA or the taxpayer was grossly negligent in failing to comply with the ITA. These larger penalties are discretionary penalties in that they do not apply purely when certain objective facts are present. Instead, before the penalties can apply, there must be an analysis of the taxpayer's *mens rea*, or mental state, and a conclusion that the taxpayer either intentionally failed to comply or was grossly negligent in failing to comply. This type of penalty is generally referred to as a "gross-negligence penalty" despite the fact that the penalty applies not only when a taxpayer is grossly negligent but also when a taxpayer intentionally fails to comply. The most commonly used gross negligence penalty is subsection 163(2) of the ITA.

An Agency auditor is the first person to undertake the analysis to determine whether the gross-negligence penalty applies. If the Agency's auditor determines that the taxpayer either intentionally failed to comply or was grossly negligent in failing to comply, the Agency auditor will impose the gross-negligence penalty. If the taxpayer files a notice of objection to the imposition of the gross-negligence penalty, the Agency's appeals officer will consider whether the gross-negligence penalty is justified. If the Agency maintains the penalty at the objection stage, the taxpayer can appeal to the Tax Court of Canada, where a Tax Court judge will consider all facts and evidence to determine whether the gross-negligence penalty is justified.

2.1 Gross-Negligence Penalties

2.1.1 Elements of the Gross Negligence Penalty

The gross-negligence penalty under subsection 163(2) of the ITA has two material elements: (1) a false statement or omission, and (2) knowledge or circumstances amounting to gross negligence.

False Statements or Omissions
163(2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or return filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty . . .

Both material elements must exist for the penalty to apply.

Subsection 163(3) of the ITA provides that the Agency has the burden of proof to establish the facts that must exist for the penalty to apply. For more on the burden of proof, see the section entitled "Burden of Proof and Standard of Proof".

False Statement or Omission

To satisfy the first element, the Agency must show that the taxpayer either made a false statement or incorrectly omitted information on a tax return. The Agency's position is the penalty will only apply to written statements a taxpayer makes to the Agency.[63] Oral statements a taxpayer makes in an interview should not form the basis for a gross-negligence penalty.

The gross-negligence penalty does not apply if a taxpayer fails to file a tax return. An omission, as it is used in subsection 163(2), refers to an omission within the tax return itself, not the omission of failing to file the tax return.[64] The failure to file a tax return implies that the taxpayer did not make any statement to the Agency and, therefore, is penalized under section 162 of the ITA.

Knowingly or in Circumstances Amounting to Gross Negligence

The second element of the gross-negligence penalty is the taxpayer's knowledge about the false statement or omission. "Circumstances amounting to gross negligence" means actions that exhibit complete disregard for the taxpayer's obligations under the ITA. If the taxpayer's actions are "circumstances amounting to gross negligence", the decision maker will impute knowledge of the misstatement or omission to the taxpayer. In *Daszkiewicz v. R.*, the Tax Court of Canada stated that the knowledge element will be satisfied when the taxpayer, "has actual knowledge of the false statement contained in his return, is wilfully blind as to the existence of the false statement, or has demonstrated recklessness or was otherwise grossly negligent in the making of, participating in, assenting to or acquiescing in the making of, the false statement".[65]

Please see the sections below entitled "Intentional False Statements or Omissions on Tax Returns" and "False Statements or Omissions on Tax Returns Due to Gross Negligence" for a detailed analysis of these elements.

2.1.2 Amount of the Gross-Negligence Penalty

Simply put, the penalty is the greater of (1) $100 and (2) 50 percent of the tax avoided. The legislation, at paragraphs 163(2)(a) to (g), provides an incomprehensively long calculation that determines the amount of the penalty. However, in most cases, the calculation reveals that the penalty is 50 percent of the tax avoided. We have reproduced subsection 163(2) in its entirety below.

False Statements or Omissions

163(2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or return filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty of the greater of $100 and 50% of the total of

(a) Where the tax that would be payable under the ITA (less any refundable abatement under subsection 120(2), as described above and any reduction under subsection 120(2.2) in respect of tax payable to an Aboriginal government) if the person's taxable income were computed by adding to the taxable income reported by the person in the person's return for the year that portion of the person's "understatement of income" for the year that is reasonably attributable to the false statement or omission (and if the person's tax payable were computed by subtracting from any deductions from tax otherwise payable the portion attributable to the false statement or omission) exceeds the tax that would have been payable (exclusive of any refundable abatement under subsection 120(2) and reduction under subsection 120(2.2)) had it been assessed on the basis of the information provided in the person's return for the year; and/or

(b) [Repealed]

(c) where the amount that would be deemed to be an overpayment on account of Part I tax liability under subsection 122.61(1), if calculated by reference to the information supplied, exceeds the amount so deemed to be overpaid on proper application of subsection 122.61(1) (which provides for the child tax benefit); and/or

(c.1) where the total amount that would be deemed paid during a specified month on account of Part I tax liability under section 122.5 (providing for a refundable GST credit) if calculated by reference to the information supplied for the purposes of section 122.5, exceeds the amount so deemed to be paid on proper application of that section; and/or

(c.2) where the amount that would be deemed under subsection 122.51(2) to be paid on account of a person's Part I tax payable for the year if calculated by reference to the information provided exceeds the amount so deemed to be paid on proper application of subsection 122.51(2) (providing for the refundable medical expense supplement); and/or

(c.3) where the total amount that would be deemed paid on account of Part I tax liability under subsection 122.7(2) or (3) (working income tax benefit—applicable to taxation years after 2006) calculated by reference to information provided in a return of income exceeds the total deemed to be paid on the proper application of those subsections and/or

(c.4) where the total amount that would be deemed paid on account of Part I tax liability under subsection 122.8(2) or (3) (refundable children's fitness credit—applicable to taxation years after 2014) calculated by reference to information provided in a return of income exceeds the total deemed to be paid on the proper application of those subsections; and/or

(d) where the amount that would be deemed paid for the year by the person by virtue of subsection 127.1(1) if calculated by reference to the information supplied on the return or form filed for purposes of subsection 127.1(1), exceeds the amount so deemed to be paid on proper application of subsection 127.1(1) (which provides for a refundable investment tax credit); and/or

(e) where the amount that would be deemed to have been paid for the year by the person by virtue of subsection 127.41(3) (in respect of the refundable tax credit for a beneficiary of a qualifying environmental trust) if calculated by reference to the person's claim exceeds the maximum the person is entitled to under that subsection; and/or

(f) where the amount that would be deemed to have been paid for the year by the person by virtue of subsection 125.4(3) (in respect of the Canadian film or video production tax credit) if calculated by reference to the information provided in the return filed exceeds the amount so deemed to be paid by the person on proper application of subsection 125.4(3); and/or

> **(g)** where the amount that would be deemed to have been paid for the year by the person by virtue of subsection 125.5(3) (in respect of the film or video production services tax credit) if calculated by reference to the information provided in the return filed exceeds the amount so deemed to be paid by the person on proper application of subsection 125.5(3).

In *Wajsfeld v. R.*, the Tax Court of Canada explained that **"**paragraph 163(2.1)(a) defines "understatement of income" for the purpose of subsection 163(2) with reference to the total of all amounts that were not reported by the individual**"**.[66] In other words, **"**an "understatement of income" means the amount by which the total unreported income exceeds the total of the amounts deductible that the person did not deduct**"**.[67]

It is important to note that subsection 163(4) provides that the amount of the gross-negligence penalty is calculated without reference to subsequent events, such as a loss carryback or carryforward. In practice, this means that if a taxpayer failed to report income in a year but does not have any tax payable in the year because the taxpayer had a loss available to carryforward to the year, the gross-negligence penalty is 50 percent of the tax that would have been payable in the year before applying the loss carryforward.

In addition, the gross-negligence penalty can apply as soon as the taxpayer knowingly files a tax return with a false statement or omission: whether the Agency issues a notice of assessment with improperly reduced tax payable or an improper refund as a result of the misstatement or omission is irrelevant in the application of the gross-negligence penalty. For example, in *Sledge v. R.*, a taxpayer claimed a refund related to business losses and requested that the losses be carried back and applied to previous years for a substantial refund. The Agency did not issue the refund and did not grant the loss carryback request because the Agency identified the false statement immediately. The Agency imposed the gross-negligence penalty and the Tax Court confirmed that the penalty was valid.[68]

2.2 Intentional False Statements or Omissions on Tax Returns

As stated previously, the second element of the gross-negligence penalty is that the taxpayer made the false statement or omission either knowingly (*i.e.*, intentionally) or under circumstances amounting to gross negligence. The Agency has the burden of proving this element.[69] It is often difficult for the Agency to prove that a taxpayer intentionally made a false statement or omission because the Agency has to prove that the taxpayer not only made the statement but that the taxpayer knew that the statement was false. In *Venne v. R.*, the Federal Court held that a taxpayer may be able to rely on the taxpayer's ignorance of the law to establish that the taxpayer did not knowingly make a false statement.[70] If the taxpayer does not know that the ITA requires reporting of a certain amount, the Agency will not be able to prove that the taxpayer knew about the false statement or was aware of the omission.

The Agency will only be able to establish that the taxpayer intentionally made the false statement or omission if the taxpayer admits to having knowledge or if the taxpayer's documents indicate that the taxpayer intentionally made the false statement. In most cases, the Agency will justify the imposition of the gross-negligence penalties on the basis that the taxpayer was grossly negligent.

2.3 False Statements or Omissions due to Gross Negligence

Absent proof that the taxpayer had knowledge of the misstatement or omission, the Agency can still impose liability under subsection [163(2)] where the Agency can prove gross negligence. The seminal case on subsection [163(2)] gross negligence penalties is *Venne v. R.*[71] In *Venne*, the Federal Court defined gross negligence as follows:

> [g]ross negligence must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not.[72]

In *De Gennaro v. R.*, the Tax Court of Canada summarized gross negligence more generally as "a marked and substantial departure from the conduct of a reasonable person in the same circumstances."[73]

The starting point for the Agency in determining the type of conduct that amounts to gross negligence is to determine if the actions of the taxpayer were unreasonable. The standard of reasonableness is an objective one — how a reasonable person would act in the same circumstances as the person against whom the penalty is assessed — and not by reference to the subjective beliefs or characteristics of this person. The Minister can establish the existence of gross negligence when the Minister can show that there was a marked and substantial departure from the conduct of a reasonable person in similar circumstances.[74]

One such departure is when a taxpayer is wilfully blind. Wilful blindness occurs when a taxpayer fails to make inquiries about something questionable because the taxpayer wants to avoid acquiring knowledge of the false statement or omission. Wilful blindness is a common-law concept — which means that the taxpayer finds the definition in the case law and not in the ITA itself.

If the Agency proves wilful blindness, then the Agency can impose the gross-negligence penalty.[75] In *Torres v. R.*,[76] the Tax Court of Canada set out the following three elements when determining whether a taxpayer was wilfully blind:

1. "consideration must be given to the education and experience of the taxpayer";[77]

2. "there must be a need or a suspicion for an inquiry";[78] and

3. "the taxpayer makes no inquiry of the tax preparer to understand the return, nor makes any inquiry of a third party, nor the CRA itself".[79]

The Federal Court of Appeal, in *Strachan v. R.*,[80] at paragraph 4, confirmed that the Tax Court set out the correct wilful-blindness test in *Torres*.

The first element — the taxpayer's education and experience — goes to whether the taxpayer was merely ignorant of the misstatement or omission. The subject matter of the misstatement or omission will, in part, dictate this analysis. For example, in *Torres*, the taxpayer had never operated a business and had never received large refunds, yet filed a tax return claiming fictitious business expenses that resulted in a significant refund. The Tax Court held that, although Torres did not understand accounting principles or the details of a tax return, Torres was not "so lacking in education or basic understanding of concepts such as business, or tax as to claim ignorance".[81] A taxpayer's gullibility is not relevant in this analysis.[82]

The second element — a need for an inquiry or a suspicion for an inquiry — relates to whether the circumstances surrounding the false statement were such that no reasonable person would have proceeded without making inquiries as to the correctness of the statement. For a finding of wilful blindness, the facts must dictate that a reasonable person would have made an inquiry. In *Torres*, the Tax Court of Canada identified the following non-exhaustive list of circumstances that create a need for inquiry:

1. the magnitude of the advantage or omission;
2. the blatantness of the false statement and how readily detectable it is;
3. the lack of acknowledgment by the tax preparer who prepared the return in the return itself;
4. unusual requests made by the tax preparer;
5. the tax preparer being previously unknown to the taxpayer;
6. incomprehensible explanations by the tax preparer;
7. whether others engaged the tax preparer or warned against doing so, or the taxpayer himself or herself expresses concern about telling others.[83]

If circumstances would lead a reasonable person in the taxpayer's shoes to suspect an irregularity and ask about it, then the failure to make the inquiry satisfies the third element of willful blindness. Moreover, if the taxpayer asks the tax preparer, third party, or Agency, and the response would still lead a reasonable person to suspect a problem, and the taxpayer does not follow up with further inquiry, then the taxpayer cannot defeat the finding of wilful blindness.

Courts have held that the Agency must establish gross negligence on a balance of probabilities and must show more than "a mere probability of misconduct".[84] As such, the Agency cannot assume or infer that a taxpayer was grossly negligent; the Agency must provide evidence on a balance of probabilities to support its position that any alternative explanation is incorrect. Where the taxpayer's explanation creates any doubt as to the taxpayer's intention, the Agency should give the benefit of the doubt to the taxpayer because of the penal nature of subsection 163(2).[85]

In *897366 Ontario Ltd. v. R.*, the Tax Court chastised the Agency for routinely imposing penalties and highlighted the importance of reviewing all evidence regarding a taxpayer's conduct before imposing gross-negligence penalties. Specifically, at paragraph 19, the Court stated the following when addressing the gross-negligence penalties under the *Excise Tax Act*, at section 285:

> The fact that not a shred of evidence supporting the section 285 penalties was adduced leads me to conclude that the Crown had none, either at trial or on assessing. The imposition of penalties under section 285 requires a serious and deliberate consideration by the taxing authority of the taxpayer's conduct to determine whether it demonstrates a degree of wilfulness or gross negligence justifying the penalty. Section 285 is not there to permit assessors to punish taxpayers for being frustrating or annoying. It cannot be overemphasized that penalties may only be imposed under section 285 in the clearest of cases, and after an assiduous scrutiny of the evidence.[86]

Simply stated, the Agency cannot impose penalties without demonstrating that the taxpayer engaged in culpable conduct.

In attempting to identify the difference between ordinary negligence and gross negligence, the TCC has identified the following factors for consideration:

1. the magnitude of the omission in relation to the income declared;

2. the opportunity the taxpayer had to detect the error;

3. the taxpayer's education and apparent intelligence; and

4. genuine effort to comply.[87]

To equip its auditors with the tools to make such a determination, the Agency has created a list of factors for consideration, entitled a Penalty Recommendation Report. Agency auditors complete a Penalty Recommendation Report to help the Agency decide whether to impose gross-negligence penalties. The following is the list of factors in the Agency's Penalty Recommendation Report:

1. the materiality of the false statement or omission;

2. whether the taxpayer or someone else was responsible for the preparation of the books, records, and tax returns;

3. the taxpayer's knowledge of tax matters;

4. the taxpayer's knowledge of income;

5. the amount of care the taxpayer took in attempting to file accurately;

6. whether the taxpayer had any prior contact with the Agency;

7. the treatment of similar income in the past;

8. whether the taxpayer examined the tax return prior to filing;

9. whether the taxpayer provided sufficient information to the person who prepared the tax return, if applicable; and

10. whether the taxpayer maintained proper books and records.

There is no single factor from this list that determines whether the gross-negligence penalties are justified. However, the authors have found that Agency auditors tend to put a significant emphasis on the **materiality** of the false statement or omission. Auditors compare the amount of taxable income unreported to the taxable income reported. Auditors typically reduce the comparison to a percentage. For example, if a taxpayer reported net business income of $100,000, but the taxpayer overclaimed $25,000 of expenses, the Agency will consider the false statement to be 25 percent of the taxpayer's income.

2.4 Additional (Gross-Negligence) Penalties for Unfiled Information Returns

2.4.1 Gross-Negligence Penalties for Failing to File Information Returns

As set out in section 1.4, subsection 162(7) of the ITA provides a penalty of up to $2,500 when a taxpayer either late files or fails to file an information return. However, failure to file certain information returns can subject a taxpayer to an increased penalty if the taxpayer did so either intentionally or under circumstances amounting to gross negligence. Specifically, the ITA, at subsection 162(10), provides that the additional penalty applies to failure to file the following forms:

Information Return	ITA Section
T106	233.1

T1141	233.2
T1134	233.3
T1135	233.4
RC4649	233.8

The application of the additional penalty depends on whether the Agency can prove that the taxpayer either (1) intentionally failed to file the form or (2) failed to file the form due to gross negligence. The principles related to what constitutes gross negligence, set out in the section above related to the gross-negligence penalty in subsection 163(2) of the ITA, equally apply to subsection 162(10). Also like the 163(2) penalty, the Agency has the burden to establish the facts to support the imposition of the penalty under subsection 162(10).

The amount of penalty under subsection 162(10) of the ITA depends on (1) how many months late the information return is and (2) whether the Agency sent to the taxpayer a demand to file the information return under section 233. First, there is a $500 per month penalty for each month (including any part of the month) since the filing deadline, up to 24 months. Second, if the Agency sent to the taxpayer a demand to file the information return under section 233, the per-month penalty is doubled. For example, if more than 24 months has passed since the filing deadline and the Agency issued a demand to file the information return, the per-month penalty is $12,000 ($500 per month × 24 months), and the total penalty is $24,000 ($12,000 penalty doubled). If the Agency had not issued the demand to file the information return, the penalty would be $12,000. Finally, the Agency reduces the penalty by the amount of the non-discretionary penalty under subsection 162(7). As a result, the maximum penalty under subsection 162(10) for the taxpayer's failure to file an information return is either $12,000 (if the Agency does not send a demand letter) or $24,000 (if the Agency sends a demand letter).

However, if the subsection 162(10) penalty applies to a failure to file a T1141 form, a T1135 form, or a T1134 form, and the taxpayer's failure to file the form exceeds 24 months, subsection 162(10.1) imposes an additional, and potentially substantial, penalty. For a failure to file a T1141 form, the additional penalty is equal to 5 percent of the taxpayer's contribution or loan to the non-resident trust.[88] For a failure to file a T1135 form, the additional penalty is equal to 5 percent of the taxpayer's cost to acquire the specified property.[89] For a failure to file a T1134 form, the additional penalty is equal to 5 percent of the taxpayer's cost to acquire shares or debt of the foreign affiliate.[90] Note that when a taxpayer does not hold shares directly in a foreign affiliate but instead holds them through a controlled foreign affiliate, subsection 162(10.2) provides that, for the purpose of calculating the additional penalty in subsection 162(10.1), the Agency deems that the taxpayer owns shares in the foreign affiliate directly. In that case, the taxpayer's cost is equal to 20 percent of the controlled foreign affiliate's cost to acquire the shares or debt in the foreign affiliate.

2.4.2 Gross-Negligence Penalties for Misstatements or Omissions on Information Returns

If a taxpayer files an information return as required under sections 233.1 to 233.4 or 233.6 (forms T106, T1141, T1142, T1134, and T1135) and that information return contains misstatements or omissions that are intentional or attributable to gross negligence under subsection 163(2.4), then the Agency imposes a penalty on the taxpayer. This penalty is reserved for misstatements or omissions on filed information returns and does not apply if a taxpayer fails to file a return. A failure to file is subject to the penalties in subsections 162(7), (10), and (10.1).

The gross-negligence principles set out above apply equally to the determination of the penalty in subsection 163(2.4).

If the Agency imposes the penalty under subsection 163(2.4), the amount of the penalty is as follows:

1. for misstatements or omissions on a T106 form (section 233.1), $24,000;

2. for misstatements or omissions on a T1141 form (section 233.2), the greater of (1) $24,000 and (2) 5 percent of the total fair market value of the taxpayer's contributions to the trust in the taxation year;

3. for misstatements or omissions on a T1135 form (section 233.3), the greater of (1) $24,000 and (2) 5 percent of the taxpayer's cost of the specified property that relates to the false statement or omission;

4. for misstatements or omissions on a T1134 form (section 233.4), the greater of (1) $24,000 and (2) 5 percent of the taxpayer's cost of the of the shares or debt in the foreign affiliate;

5. for misstatements or omissions on a T1142 form (section 233.6), the greater or $2,500 and (2) 5 percent of the value of all property the non-resident trust distributed to the taxpayer that relates to the false statement or omission plus 5 percent of any debt the taxpayer owes to the non-resident trust that relates to the false statement or omission.

2.5 Transfer-Pricing Penalties

Section 247 of the ITA addresses transfer pricing. The transfer-pricing regime is complex and is beyond the scope of this Practical Insight.[91] For the purposes of this Practical Insight, it is sufficient to state that the transfer-pricing provisions require that Canadian taxpayers that engage in transactions with related non-resident entities do so on the same terms and conditions that arm's-length parties would transact. In other words, the Canadian entity in the related-party transaction must earn profit in Canada that is the same that it would earn if it had transacted with an unrelated party. Moreover, the Canadian taxpayer must prepare documents — at the time it enters into the transaction with the related non-resident entity — to support that the profit the Canadian taxpayer earns is market value.

If a Canadian taxpayer fails to comply with the transfer-pricing provisions, the Agency can process transfer-pricing capital and income adjustments and impose a penalty under subsection 247(3) of the ITA.

The Transfer Pricing Review Committee (TPRC) determines whether to impose the transfer-pricing penalties. The TPRC's reviews are limited to determining whether the taxpayer used reasonable efforts to determine and to use an appropriate arm's-length price for the related-party transaction. As of December 31, 2020, the TPRC recommended penalties in roughly 42 percent of the cases considered (342 out of 810 cases).[92]

The taxpayer can have the penalty reduced or avoided where the taxpayer "made reasonable efforts to determine arm's length prices" and the taxpayer used the prices. At the minimum, subsection 247(4) creates documentary requirements for the taxpayer, and if the taxpayer does not comply with the requirements, then the Agency will deem the taxpayer to have not made reasonable efforts.

For more information on transfer pricing and the transfer-pricing penalty, including calculating the transfer-pricing penalty, see the Practical Insight on Transfer Pricing.

2.6 Zapper Penalties

Effective January 1, 2014, subsection 163.3 of the ITA provides that taxpayers that use zappers, possess zappers, or make zappers available for sale are subject to penalties. A zapper is a device or program that suppresses sales. A business will use zapper technology to suppress sales from its records to allow the business to underreport revenue.

The ITA, at subsection 163.3(1), defines a zapper, or "electronic suppression of sales device" as follows:

> ***electronic suppression of sales device*** means
>
> > **(a)** a software program that falsifies the records of electronic cash registers, including transaction data and transaction reports; or
> >
> > **(b)** a hidden programming option, whether preinstalled or installed at a later time, embedded in the operating system of an electronic cash register or hardwired into the electronic cash register that
> >
> > > (i) may be used to create a virtual second till, or
> > >
> > > (ii) may eliminate or manipulate transaction records, which may or may not be preserved in digital formats, in order to represent the actual or manipulated record of

transactions in the electronic cash register. (appareil de suppression électronique des ventes)

There are three separate penalties: one for **using** a zapper, one for **possessing** a zapper, and one for **making a zapper available** for others to use.

Under subsection 163.3(2), the first-offence penalty for using a zapper is $5,000,[93] and the second-offence penalty for using a zapper is $50,000.[94] The second-offence penalty only applies if the Agency previously assessed the taxpayer a penalty under subsection 163.3 of the ITA or under section 285.01 of the *Excise Tax Act* (*i.e.*, the corresponding penalty provision under the ETA). To impose a penalty against a taxpayer for using a zapper, the Agency must establish that the taxpayer either (1) knowingly used the zapper or (2) used the zapper in circumstances attributable to neglect, carelessness, or wilful default. Note that the Agency does not have to establish that the taxpayer was grossly negligent. Proving that a taxpayer used a zapper due to the taxpayer's neglect, carelessness, or wilful default requires that the Agency prove that a taxpayer was negligent, not grossly negligent. Subsection 163.3(7) explicitly provides that the taxpayer cannot advance a due-diligence defence to defend against a penalty for using a zapper.

Under subsection 163.3(3), the first-offence penalty for possessing a zapper that is being used or is capable of being used is $5,000.[95] The second-offence penalty for possessing a zapper that is being used or is capable of being used is $50,000.[96] Again, the second-offence penalty only applies if the Agency previously assessed the taxpayer a penalty under subsection 163.3 of the ITA or under section 285.01 of the ETA. Possessing a zapper is a question of fact. The Agency does not have to establish that the taxpayer was aware that the taxpayer possessed the zapper. However, subsection 163.3(8) specifically provides that a taxpayer can advance a due-diligence defence to refute the penalty for possessing a zapper. To succeed in advancing a due-diligence defence, the taxpayer has the burden to establish that the taxpayer "exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances to prevent"[97] the taxpayer from possessing the zapper.

Subsection 163.3(4) sets out the penalties for making zappers. Specifically, it provides that the penalties apply to "every person that designs, develops, manufactures, possesses for sale, offers for sale, sells, transfers or otherwise makes available to another person, or that supplies installation, upgrade or maintenance services for, an electronic suppression of sales device". The first-offence penalty is $10,000.[98] The second-offence penalty is either (1) $50,000 if the previous penalty was for using or possessing a zapper[99] or (2) $100,000 if the previous penalty was under subsection 163.3(4) of the ITA or subsection 285.01(4) of the ETA.[100] Subsection 163.3(8) provides that a taxpayer can advance a due-diligence defence to refute the penalty under subsection 163.3(4). To succeed in advancing a due-diligence defence, the taxpayer has the burden to establish that the taxpayer "exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances to prevent"[101] the taxpayer from the specific acts giving rise to the penalty.

3. Third-Party Penalties

3.1 Preparer and Advisor Penalties

In 2000, Parliament enacted subsection 163.2 of the ITA to penalize tax promoters, planners, and preparers in cases where these individuals encourage other taxpayers to engage in conduct contrary to the ITA. There are two separate penalties under subsection 163.2:

1. a penalty for making a false statement on another person's tax filings or that could cause another person to make a false statement on the other person's tax filings (subsections 163.2(2) and (3)); and

2. a penalty for making a false statement to another person where the other person could use the false statement on the person's tax filings (subsections 163.2(4) and (5)).

Penalty for misrepresentations in tax planning arrangements

> **(2)** 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 another person (in subsections (6) and (15) referred to as the "other person") for a purpose of this Act is liable to a penalty in respect of the false statement.

Amount of penalty

> **(3)** The penalty to which a person is liable under subsection (2) in respect of a false statement is
>
> > **(a)** where the statement is made in the course of a planning activity or a valuation activity, the greater of $1,000 and the total of the person's gross entitlements, at the time at which the notice of assessment of the penalty is sent to the person, in respect of the planning activity and the valuation activity; and
> >
> > (b) in any other case, $1,000.

Penalty for participating in a misrepresentation

(4) Every person who makes, or participates in, assents to or acquiesces in the making of, a statement to, or by or on behalf of, another person (in this subsection, subsections (5) and (6), paragraph (12)(c) and subsection (15) referred to as the "other 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 is liable to a penalty in respect of the false statement.

Amount of penalty

(5) The penalty to which a person is liable under subsection (4) in respect of a false statement is the greater of

(a) $1,000, and

(b) the lesser of

(i) the penalty to which the other person would be liable under subsection 163(2) if the other person made the statement in a return filed for the purposes of this Act and knew that the statement was false, and

(ii) the total of $100,000 and the person's gross compensation, at the time at which the notice of assessment of the penalty is sent to the person, in respect of the false statement that could be used by or on behalf of the other person.

In both cases, the penalty will apply if the third party either (1) knows that the other person could use the false statement in a tax filing or (2) if not for the third party's culpable conduct, the third party would have known that the other person could use the false statement in a tax filing. Culpable conduct is defined in subsection 163.2(1) as follows:

culpable conduct means conduct, whether an act or a failure to act, that

(a) is tantamount to intentional conduct;

(b) shows an indifference as to whether this Act is complied with; or

(c) shows a wilful, reckless or wanton disregard of the law.

The culpable conduct definition is analogous to the common law test for what constitutes gross negligence.[102]

Note that, although the provisions refer only to a false statement and not to an omission, subsection 163.2(1) defines "false statement" to include an omission. In other words, the provisions apply to both a statement that can lead another person to make a false statement or an omission on a tax filing.

The amount of the penalty under subsection 163.2(3) will typically be the amount of the third party's gross compensation related to the planning activity. The amount of the penalty under subsection 163.2(5) will typically be the greater of (1) the third party's gross compensation related to the false statement plus $100,000 and (2) the amount of the gross-negligence penalties the Agency would impose against the other person(s) as a result of the false statement. As of October 2022, the average penalty the Agency had imposed was over $2.7 million.[103]

Note that the language of subsections 163.2(2) and (4) is intentionally broad to capture all types of third party culpable conduct. In particular, subsection 163.2(2) states that the provisions apply to every person who:

1. makes a false statement,
2. furnishes a false statement,
3. participates in the making of a false statement,
4. causes another person to make a false statement, or
5. causes another person to furnish a false statement.

Similarly, subsection 163.2(4) applies to every person who

1. makes a false statement,
2. participates in the making of a false statement,
3. assents to the making of a false statement, or
4. acquiesces in the making of a false statement,

and the false statement is

1. to another person,
2. by another person, or

3. on behalf of another person.

The intent of the legislation is to capture all instances of third-party culpable conduct. The common instances in which the Agency has issued third-party penalties are charitable donation arrangements, fraudulent or fictitious expenses or losses, appropriations of corporate amounts, and improper scientific research and experimental development claims.

3.1.1 Guindon v. The Queen – Defences to Third-Party Penalties

The seminal case on third-party penalties under subsection 163.2 of the ITA is *Guindon*, which went to the Supreme Court of Canada. The primary issue in *Guindon* was whether the third-party penalty was criminal or civil in nature. If the third-party penalty was criminal in nature, creating a criminal offence, Ms. Guindon (and all taxpayers) would be entitled to the protections under the *Canadian Charter of Rights and Freedoms*; in that event, the third-party penalty would be rendered unconstitutional because it would violate the presumption of innocence (section 11 of the *Charter*). The secondary issue related to a question of whether the Courts had jurisdiction to hear Ms. Guindon's *Charter* argument.

The relevant facts are as follows. Ms. Guindon was a lawyer who prepared a legal opinion in support of a charitable donation tax shelter program without reviewing the program's underlying documents. In addition, she signed 135 tax receipts. The Agency established that the donation program did not comply with the ITA and imposed a penalty against Ms. Guindon under section 163.2 in the amount of $546,747.

At the Tax Court of Canada level,[104] Ms. Guindon successfully argued that the penalty created a criminal offence rather than a civil penalty and, therefore, she was entitled to the protections under section 11 of the *Charter*. The Tax Court vacated the penalty assessment.

The Minister appealed the Tax Court decision to the Federal Court of Appeal. The Federal Court of Appeal granted the Minister's appeal on the basis that that the Tax Court did not have jurisdiction to find that the subsection 163.2 penalty was an offence and that section 11 of the *Charter* applied.[105] Neither the Tax Court nor the Federal Court of Appeal have inherent jurisdiction to hear constitutional questions. Pursuant section 19.2 of the *Tax Court of Canada Act* and section 57 of the *Federal Courts Act*, for Ms. Guindon to argue that the Charter applied, she was required to serve on the federal and provincial Attorneys General a notice of the constitutional question — whether the 163.2 penalty gives rise to *Charter* rights — at least 10 days before the hearing. Ms. Guindon did not and, therefore, neither the Tax Court of Canada nor the Federal Court of Appeal could consider whether the 163.2 penalty was a criminal offence that entitled Ms. Guindon to *Charter* remedies.

In addition to deciding the jurisdictional issue in favour of the Minister, the Federal Court of Appeal held that the 163.2 penalty did not create a criminal offence. The Court's bases for the decision were:

1. the 163.2 penalty's aim is to maintain discipline and compliance within a regulatory and administrative field (*i.e.*, compliance with the ITA), rather than to redress a public wrong done to a society at large;

2. a penalty provision creates a financial penalty determined by a non-discretionary formula, whereas an offence provision establishes a range of potential sanctions, including fine and or imprisonment; and

3. the fact that a 163.2 penalty may be a significant amount, on its own, does not establish the 163.2 penalty as a criminal offence because administrative penalties may have to be significant in order to achieve the purpose of deterring certain conduct.

Ms. Guindon appealed the Federal Court of Appeal's decision to the Supreme Court of Canada. The Supreme Court dismissed Ms. Guindon's appeal.[106] In doing so, the majority decision held that it had jurisdiction to consider the *Charter* argument, but agreed with the Federal Court of Appeal's decision that the subsection 163.2 penalty did not create a criminal offence. The Supreme Court of Canada's decision confirms that the subsection 163.2 penalty is a civil penalty and taxpayers are not entitled to *Charter* rights and protections as a defence.

3.1.2 Reliance-in-Good-Faith Defence

Subsection 163.2(6) of the ITA provides that a third party can avoid the imposition of the section 163.2 penalty if the third party relied on information provided by or on behalf of the other person — provided that subsection 163.2(7) does not apply. The good-faith defence is distinct from a due-diligence defence. The basis for this defence is that the third party is entitled to rely on accurate information from the other person and is excused of actions that would otherwise be culpable conduct.

The Tax Court confirmed that the reliance in good faith defence does not apply unless (1) the information relied on is provided by the taxpayer, and (2) the advisor is acting on behalf of the taxpayer.[107]

IC-01-1, Third-Party Civil Penalties, states that defence set out in subsection 163.2(6) will apply where "the information used by the advisor or tax return preparer is not on its face, clearly false, or obviously unreasonable to a prudent person or does not raise obvious questions in the mind of the advisor or tax return preparer".[108] IC-01-1 provides examples of the appropriate use of this defense, such as the reliance on financial statements prepared by another adviser which are not obviously unreasonable and the reliance on a list of business expenses provided by the client which is reasonable on its face but turn out to be false.[109] It is important to note that under to subsection 163.2(7), the good faith defence will not apply to statements that are not made in the course of "excluded activities". "Excluded activities" include the activities of promoting, selling, or accepting consideration for, an arrangement or plan that concerns flow-through shares or a tax shelter, or an arrangement where one of the main purposes for the person's participation in the arrangement or plan is to obtain a tax benefit.[110]

3.2 Tax Shelter Promoter Penalties

The tax shelter regime is highly regulated under the ITA. A person that is a "promoter" of a tax shelter, as defined in subsection 237.1(1), is required to apply for a tax shelter identification number under the prescribed rules of the ITA and is required to file certain information regarding taxpayers that invest in or purchase tax shelters. A promoter that fails to comply with the obligations is subject to penalties under subsections 237.1(7.4) and (7.5).

For detailed analysis and information on the promoter definition and the application of the penalties against promoters that fail to comply with the obligations under the ITA, please see the Practical Insight on Tax Shelters.

3.3 Mandatory Disclosure Rules Penalties

The enhanced mandatory disclosure rules discussed in sections 1.8.1 to 1.8.2 introduce a penalty for tax advisors and promoters who fail to file an information return related to reportable or notifiable transactions that they are required to report under sections 237.3 and 237.4, respectively. Advisors and promoters are not required to file an information return related to an uncertain tax treatment and therefore, no penalty exists.

In general, an advisor is a person who provides (directly or indirectly) any contractual protection, assistance, or advice in respect of the reportable or notifiable transaction or series, or provides any assistance or advice with respect to creating, developing, planning, organizing or implementing the transaction or series, to another person (including any person who enters into the transaction for the benefit of another person).[111]

A promoter (in relation to the mandatory disclosure rules) is a person that directly or indirectly,

- (a) promotes or sells an arrangement, plan, or scheme, if it may reasonably be considered that the arrangement includes or relates to the transaction or series;
- (b) makes a statement or representation that a tax benefit could result from an arrangement, if it may reasonably be considered that (i) the statement or representation was made in furtherance of the promoting or selling of the arrangement; and (ii) the arrangement includes or relates to the transaction or series; or
- (c) accepts consideration in respect of an arrangement referred to in paragraphs (a) or (b).[112]

In certain situations, an individual might meet the criteria outlined in both paragraphs 237.3(2)(b) and (d) or 237.4(4)(b) and (d) regarding the same reportable or notifiable transaction. This means the person could be someone who engages in a reportable or notifiable transaction for the benefit of another person and also has a non-arm's length relationship with an advisor or promoter regarding the transaction, while being entitled to a fee. In these circumstances, if a failure to file penalty applies to such a person, subsections 237.3(8.1) and

237.4(13) specify that the person is only liable up to the of the amounts determined under paragraphs 237.3(8)(a) and (b) or 237.4(12)(a) and (b), respectively.

The penalties for non-compliance with the new mandatory disclosure rules for advisors and promoters are summarized as follows:[113]

	Failure to File Reportable or notifiable transactions (Corporations with $50 million assets or more)	**Failure to File Reportable or notifiable transactions (All other taxpayers)**	**Failure to File Uncertain Tax Treatment**
Each Promoter or Advisor	**Total of**: a. 100% of the fees charged for the transaction; b. $10,000; and c. $1,000 per day to a maximum of $100,000	Total of: a. 100% of the fees charged for the transaction; b. $10,000; and c. $1,000 per day to a maximum of $100,000	Not applicable

Penalty – Reportable Transactions

237.3(8) Every person who fails to file an information return in respect of a reportable transaction as required under subsection (2) on or before the day required under subsection (5) is liable to a penalty equal to

(b) if the person is described in paragraph (2)(c) or (d), the total of

(i) the amount of the fees charged by that person in respect of the reportable transaction,

(ii) $10,000, and

(iii) $1,000 multiplied by the number of days during which the failure continues, up to a maximum of $100,000.

Penalty – deeming rule

(8.1) If a person described in both paragraphs (2)(b) and (d) is liable to a penalty under subsection (8) in respect of a reportable transaction, the amount of the penalty is deemed to be equal to the greater of the amounts determined under paragraphs (8)(a) and (b).

Penalty – Notifiable Transactions

237.4(12) Every person who fails to file an information return in respect of a notifiable transaction as required under subsection (4) on or before the particular day required under subsection (9) is liable to a penalty equal to

(b) if the person is described in paragraph (2)(c) or (d), the total of

(i) the amount of the fees charged by that person in respect of the reportable transaction,

(ii) $10,000, and

(iii) $1,000 multiplied by the number of days during which the failure continues, up to a maximum of $100,000.

(b) if the person is described in paragraph (4)(c) or (d), the total of

(i) the amount of the fees charged by that person in respect of the notifiable transaction,

(ii) $10,000, and

(iii) $1,000 multiplied by the number of days during which the failure continues, up to a maximum of $100,000.

Penalty – deeming rule

(13) If a person described in both paragraphs (4)(b) and (d) is liable to a penalty under subsection (12) in respect of a notifiable transaction, the amount of the penalty is deemed to be equal to the greater of the amounts determined under paragraphs (12)(a) and (b).

3.3.1 Defences to the Mandatory Disclosure Rules Penalties for Advisors and Promoters

For reportable transactions, the due diligence defence in subsection 237.3(11) applies to advisors, promoters, or persons who do not deal at arm's length with the advisors or promoters and are entitled to a fee in respect of the reportable transaction. As discussed in section 1.8.6, this due diligence defence provides that these persons are not liable for a failure to file a penalty if the person exercised the degree of care, diligence, and skill to prevent the failure to file that a reasonably prudent person would have exercised in comparable circumstances.

As discussed, although no case law exists surrounding this due diligence defence, the language in this due diligence defence is the same as the director's liability due diligence defence set out in subsection 227.1(3). Subsection 227.1(3) has been extensively discussed and litigated at the Tax Court of Canada and the Federal Court of Appeal, and the principles and guidance set out by the Courts should apply equally to the due diligence defence in subsection 237.3(11).

On the other hand, for notifiable transactions, the same due diligence does not apply to advisors or promoters. However, subsection 237.4(7) of the ITA states that the failure to file penalty does not apply to advisors, promoters, or persons who do not deal at arm's length with the advisors or promoters in respect of a notifiable transaction *unless* the person knows or should reasonably be expected to know that the transaction was a notifiable transaction. Therefore, if the advisor or promoter can show that they did not know and should not reasonably be expected to know the transaction was a notifiable transaction, then the filing requirement does not apply and the advisor or promoter will not be liable for a failure to file penalty.

In effect, the application of the failure to file penalty to an advisor or promoter who "should reasonably be expected to know that the transaction was a notifiable transaction" puts a higher standard on advisors and promoters.

4. Special Considerations

4.1 Burden of Proof and Standard of Proof

The burden of proof differs depending on the type of penalty. For non-discretionary penalties, the Minister can assume the facts necessary to support the penalty and, therefore, the taxpayer has the burden to demolish the Minister's assumptions. However, for certain discretionary penalties — gross negligence penalties under subsection 163(2) and third-party penalties under section 163.2 — the Minister has the burden of proof to establish the facts to support the penalties.[114] Taxpayers have the burden of proof to establish the facts to support any defence to the imposition of penalties.

In all cases, the standard of proof is a balance of probabilities. The balance of probabilities standard requires evidence that establishes that something is more likely than not.[115]

However, the Tax Court of Canada has indicated that it will hold the Minister to a high evidentiary standard when reviewing the potential imposition of gross-negligence penalties. In particular, the Tax Court of Canada has provided the following guidance on the Minister's evidentiary standard:

1. "the burden on the Minister is a heavy one";[116]

2. if "the taxpayer's conduct with two viable and reasonable hypotheses, one justifying the penalty and one not, the benefit of the doubt must be given to the taxpayer and the penalty must be deleted";[117] and

3. "if there is any doubt about intent, the benefit of that doubt should go to the taxpayer since the penalty provision in question is penal in nature."[118]

Below is an excerpt that the authors routinely include in submissions to the Agency explaining the standard of proof related to gross-negligence penalties under subsection 163(2):

> The courts have held that the Agency must establish gross negligence on a balance of probabilities and must show more than "a mere probability of misconduct". As such, the Agency cannot assume or infer that a taxpayer was grossly negligent. Rather the Agency must provide evidence to both support its position and demonstrate that any alternative explanation is incorrect. Where the taxpayer's explanation creates any doubt as to the taxpayer's intention, the taxpayer should get the benefit of the doubt because of the penal nature of gross-negligence penalties.

In light of the high level of proof that the courts require the Minister to meet to impose penalties under section 163 or 163.2, the Agency will complete an internal "Penalty Recommendation Report" before applying penalties to ensure that the Agency will be able to meet its burden. See section 2.3, False Statements or Omissions due to Gross Negligence above for a description of the contents of the Penalty Recommendation Report.

4.2 Gross-Negligence Penalties when the Underlying Dispute Relates to a Legal Characterization

For the purpose of the gross-negligence penalty under subsection 163(2) of the ITA, a false statement is a misstatement of fact, not an incorrect legal characterization of an amount. For example, if a taxpayer underreports business income, overclaims business expenses, improperly claims capital losses or non-capital losses, *etc.*, the taxpayer is making false statements.

On the other hand, if a taxpayer adopts the incorrect legal characterization of an amount — *e.g.*, reporting proceeds of disposition on capital account instead of on income account — and it was reasonable for the taxpayer to adopt such an interpretation, the taxpayer will not have made a misstatement of fact and, therefore, the gross-negligence penalty should not apply.

5. Tips and Traps

5.1 Strategies for Avoiding Penalties – Voluntary Disclosures Program

A taxpayer who becomes aware of prior non-compliance and potential penalties under the ITA may be able to avoid penalties if the taxpayer comes forward and provides the Agency full disclosure of his or her non-compliance. The ITA, at subsection 220(3.1), gives the Minister discretionary authority to waive or cancel penalties otherwise payable under the ITA. If a taxpayer is liable or potentially liable for a penalty under the ITA, the Agency's Voluntary Disclosures Program ("VDP") provides an avenue to avoid penalties.

To obtain relief under the VDP, the taxpayer must come forward and provide complete disclosure of all non-compliance voluntarily. The Agency's information circular regarding the VDP states that the Agency will only accept an application under the VDP and grant relief in the following circumstances:

1. the application is voluntary;
2. the application is complete;
3. the application involves the application or potential application of a penalty;
4. the application includes information that is at least one year past due; and
5. the application includes payment of the estimated tax owing.[119]

Based on the nature of the disclosure the Agency will grant penalty relief under two different tracks of relief, the General Program and the Limited Program. The Agency has stated that "In general terms, the Limited Program provides limited relief for applications that disclose non-compliance where there is an element of intentional conduct on the part of the taxpayer or a closely related party."[120]

Under the General Program, the Agency will grant relief from **all discretionary and non-discretionary penalties** that would be applicable within the previous 10 years before the year in which the taxpayer applies.[121] For example, if a taxpayer discloses unreported income over the past 15 taxation years, the Agency will not apply late-filing penalties on any taxation year that falls within the previous 10 years.

1. Under the Limited Program, the Agency will grant relief **only from discretionary penalties** for all years within the previous 10 years before the year in which the taxpayer applies.[122]

One of the requirements for the Agency to accept an application under the VDP is that the application must be voluntary. The Agency has stated that an application will not be voluntary where the taxpayer is aware that the Agency is set to conduct, or has initiated an audit, examination, or investigation concerning the information the taxpayer is disclosing.

5.2 Strategies for Disputing Penalties

After the Agency has imposed penalties, a taxpayer can file a notice of objection to dispute the imposition of penalties and, if the Agency's appeals officer confirms the penalties, can appeal the imposition of penalties to the TCC.

When the Agency has imposed discretionary penalties and the taxpayer disputes the reassessment, the Agency's appeals officer or the Department of Justice Lawyer may be willing to settle the dispute on the basis that the Agency will vacate the discretionary penalty. In fact, it is possible that Agency auditors are heavy handed with imposing discretionary penalties so that the Agency can later "concede" at the objection or appeal stage to resolve the dispute.

Depending on the other issues in dispute in the reassessment, resolving the dispute on the basis that the Agency will vacate the discretionary penalties may be a significant victory for taxpayers. Consider the following example. A Canadian taxpayer had three foreign affiliates in the 2015 taxation year but failed to file T1134 information returns. Under section 233.4 of the ITA, the taxpayer was required to file a T1134 information return supplements for each foreign affiliate. There is no dispute that the taxpayer is subject to the penalties under subsection 162(7) of the ITA. The penalty is equal to $2,500 for each foreign affiliate. However, the Agency takes the position that the taxpayer intentionally failed to file T1134 forms and, therefore, the Agency imposes the increased penalties under subsections 162(10) and (10.1). The penalty for each foreign affiliate is the greater of $12,000 and 5 percent of the taxpayer's cost to acquire shares and debt in the foreign affiliate. If the taxpayer's cost to acquire the shares in each foreign affiliate is $1 million, the taxpayer is subject to a $50,000 penalty for each foreign affiliate. Simply put, the non-discretionary penalty is

$7,500. The discretionary penalty is $150,000. In this case, settling the matter on the basis that the Agency will vacate the discretionary penalty is a significant victory.

6. Government Publications

Information Circulars

IC01-1 Third-Party Civil Penalties; and

IC00-1R6 Voluntary Disclosures Program.

Forms and Guides

RC4649 – Country-by-Country Report;

T106 - Information Return of Non-Arm's Length Transactions with Non-Residents;

T1134 - Information Return Relating To Controlled and Not-Controlled Foreign Affiliates (2011 and later taxation years);

T1135 - Foreign Income Verification Statement;

T1141- Information Return in Respect of Contributions to Non-Resident Trusts, Arrangements or Entities;

T1142 - Information Return in Respect of Distributions from and Indebtedness to a Non-Resident Trust;

T1161 - List of Properties by an Emigrant of Canada;

T2062 - Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Taxable Canadian Property;

T3010 - Registered Charity Information Return; and

T4001 Employer’s Guide – Payroll Deductions and Remittances.

Mandatory Disclosure Rules Guidance

CRA View Documents

Views Document 2010-0356361I7;

Views Document 2011-0421151E5;

Views Document 2012-0453211C6; and

Views Document 2012-0462921C6.

7. Additional Reading

Aprile, Peter V. & Moussadji, Yoni, *Practical Insight—Tax Shelters* (Toronto: Thompson Reuters 2017).

Campbell, Colin, *Administration of Income Tax 2018* (Toronto: Carswell 2018), §11 "Penalties".

Chodikoff, David W. & Loyer, Jane A., *Practical Insight—Transfer Pricing (Miller Thompson LLP)* (Toronto: Thompson Reuters 2018).

Sherman, David (ed.) *Practitioner's Income Tax Act*, 63rd ed (Toronto: Carswell, 2023).

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[1] *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) as amended [ITA], subsection 150(1).
[2] If an individual dies between November 1 and December 31, the deceased individual's deadline to file the tax return is six months after the day of death.
[3] If an individual dies between November 1 and December 31, the deceased individual's deadline to file the tax return is six months after the day of death.
[4] *Wichartz v. R.*, 1995 CarswellNat 300, (*sub nom.* Wichartz v. Canada) [1995] 1 C.T.C. 2866 (T.C.C.).
[5] *Strimaitis v. R.*, 2013 TCC 274, 2013 CarswellNat 3165, 2013 CarswellNat 4348 (T.C.C. [Informal Procedure]) [*Strimaitis*], at para. 3.
[6] See *Dunlop v. R.*, 2009 TCC 177, 2009 CarswellNat 763, 2009 CarswellNat 6384 (T.C.C. [Informal Procedure]), at para. 4; Agency View Document 2010-0356361I7; and Agency View Document 2012-0462921C6.
[7] *Strimaitis*, *supra* note 5.
[8] *Pillar Oilfield Projects Ltd. v. R.*, 1993 CarswellNat 44, (*sub nom.* Pillar Oilfield Projects Ltd. v. Canada) [1993] G.S.T.C. 49 (T.C.C.) [*Pillar*], at para. 11.
[9] *Ibid.* at para. 10, citing *R. v. Sault Ste. Marie (City)*, 1978 CarswellOnt 24, 1978 CarswellOnt 594, [1978] 2 S.C.R. 1299 (S.C.C.).
[10] *Ibid.*
[11] Résidences Majeau Inc. *c. R.*, 2010 FCA 28, 2010 CarswellNat 149, 2010 CarswellNat 782 (F.C.A.) [*Résidences Majeau*], at para. 8.
[12] *Ibid.* at para 9.
[13] *Corp. de l'École Polytechnique c. R.*, 2004 FCA 127, 2004 CarswellNat 817, 2004 CarswellNat 2170 (F.C.A.), at para. 36.
[14] *Galachiuk v. R.*, 2014 TCC 188, 2014 CarswellNat 1902, 2014 CarswellNat 8625 (T.C.C. [General Procedure]) [*Galachiuk*], at para. 26.
[15] The Respondent only relied on Galachiuk's failure to report income in the previous taxation year and not both taxation years, *Ibid.* at para. 16.

[16] *Ibid.* at para. 15.
[17] *Ibid.* at para. 8.
[18] *Ibid.*
[19] 2015 TCC 164, 2015 CarswellNat 2404, 2015 CarswellNat 4585 (T.C.C. [Informal Procedure]), at para. 5.
[20] *Greenstreet v. R.,* 2019 TCC 237, 2019 CarswellNat 5659, 2019 CarswellNat 8497 (T.C.C. [Informal Procedure]), at para. 25.
[21] *Zhang v. R.,* 2020 TCC 49, 2020 CarswellNat 2411, 2020 CarswellNat 2411 (T.C.C. [Informal Procedure]), at para. 34.
[22] *Résidences Majeau*, *supra* note 11, at para. 8.
[23] See the T1135 Information Return Instructions, available online at https://www.canada.ca/content/dam/cra-arc/formspubs/pbg/t1134/t1134-fill-21e.pdf.
[24] See the T1135 Information Return Instructions, available online at https://www.canada.ca/content/dam/cra-arc/formspubs/pbg/t1135/t1135-fill-23e.pdf.
[25] ITA, *supra* note 1 at section 233.7.
[26] See the T1134 Information Return Instructions, available online at, https://www.canada.ca/content/dam/cra-arc/formspubs/pbg/t1134/t1134-fill-21e.pdf , which states the following: "[t]his return is to be filed by a reporting entity only in respect of a foreign affiliate in which the reporting entity or a controlled foreign affiliate of the entity has a direct equity percentage at any time in the reporting entity's taxation year."
[27] See the T1134 Information Return Instructions, available online at https://www.canada.ca/content/dam/cra-arc/formspubs/pbg/t1134/t1134-fill-21e.pdf
[28] *Douglas v. R.*, 2012 TCC 73, 2012 CarswellNat 479, 2012 CarswellNat 1050 (T.C.C. [Informal Procedure]), at paras. 14 to 17, followed in *Moore v. The Queen,* 2019 TCC 141, 2019 CarswellNat 3028 (T.C.C. [Informal Procedure]), at para 18 to 21.
[29] See the Agency Audit Manual, Chapter 28.0 - Penalties, at para. 28.2.3.
[30] The documents required to be filed for a capital dividend election are Form T2054, a certified copy of the directors' resolution declaring the dividend and electing to treat it as a capital dividend, and a capital dividend account calculation.
[31] Although the amount payable under subsection 184(2) is referred to as an "additional tax", it has all the earmarks of a strict-liability penalty.

[32]The prescribed information is (1) a letter stating that the corporation is making the election; (2) a certified copy of the directors' resolution; (3) directors' declaration that the election is made with concurrence of shareholders entitled to receive the dividend; and (4) a schedule with the date of the NOA, the date and amount of the dividend, the portion of the excess, the portion, if any, that the corporation is claiming an election for under paragraph 184(3)(b), and the portion, if any, deemed by paragraph 184(3)(c) to be a separate taxable dividend.
[33] *Maxi Maid Services Ltd. v. R.*, 2012 TCC 178, 2012 CarswellNat 1637, 2012 CarswellNat 2473 (T.C.C. [Informal Procedure]).
[34] See the Agency's website online at https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/payroll/remitting-source-deductions/how-when-remit-due-dates.html).
[35] See the Department of Finance's Technical Notes to ITA, subsection 227(8.5).
[36] *Consolidated Canadian Contractors Inc. v. R.*, 1998 CarswellNat 1849, 1998 CarswellNat 2809, (*sub nom.* Canada (Attorney General) v. Consolidated Canadian Contractors Inc.) [1999] 1 F.C. 209 (Fed. C.A.).

[37] *J.K. Read Engineering Ltd. v. R.*, 2014 TCC 309, 2014 CarswellNat 4126, 2014 CarswellNat 6232 (T.C.C. [General Procedure]) [*J K Read*], at para. 17.
[38] Department of Finance's Technical Notes to ITA, *supra* note 35, subsection 227(8.5).
[39] *J K Read*, *supra* note 37 at para 17.
[40] See Budget 2023 Tax Measures at www.budget.canada.ca/2023/report-rapport/tm-mf-en.html.
[41] See Government Bill (House of Commons) C-59 (44-1) - First Reading - Fall Economic Statement Implementation Act, 2023 at https://www.parl.ca/DocumentViewer/en/44-1/bill/C-59/first-reading.
[42] *Deans Knight Income Corp. v. Canada*, 2023 SCC 16.
[43] See Government Bill (House of Commons) C-59 (44-1) - at https://www.parl.ca/legisinfo/en/bill/44-1/c-59.
[44] *Ibid.*
[45] See Explanatory Notes to Legislative Proposals Relating to the Income Tax Act and Regulations at fin.canada.ca/drleg-apl/2023/ita-lir-0823-n-1-eng.html.
[46] *Ibid*.
[47] *Ibid.*
[48] ITA, *supra* note 1 at section 237.3.
[49] *Ibid.* at section 237.4.
[50] *Ibid*. at section 237.5.
[51] *Ibid*. at paragraphs 152(4)(b.5) and (b.6).
[52] *Ibid*. at paragraphs 237.3(8), 237.4(12) and 237.5(5).
[53] Canada Revenue Agency's Mandatory Disclosure Rules – Guidance at https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/mandatory-disclosure-rules-overview/guidance-document.html#toc2.
[54] ITA, *supra* note 1 at subsections 237.3(2) and (5).
[55] See Notifiable Transaction Designated by the Minister of National Revenue at https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/mandatory-disclosure-rules-overview/notifiable-transactions-designated-by-minister-national-revenue.html.
[56] ITA, *supra* note 1 at subsections 237.3(2) and (5).
[57] *Ibid*. at subsection 237.5(1).
[58] *Ibid.* at subsection 237.5(3).
[59] *Ibid.* at subsection 237.3(7), 237.4(11), and 237.5(4).
[60] See Canada Revenue Agency's Mandatory Disclosure Rules Guidance, *supra* note 53.
[61] ITA, *supra* note 1 at subsections 237.3(17) and 237.4(18).
[62] *Ibid.* at subsections 237.3(4) and 237.4(8).
[63] See Agency View Document 2011-0421151E5.
[64] See *Last v. R.*, 2012 TCC 352, 2012 CarswellNat 3848, 2012 CarswellNat 5517 (T.C.C. [General Procedure]), at para. 127, affirmed 2014 CarswellNat 1660, 2014 CarswellNat 4889 (F.C.A.), leave to appeal refused 2014 CarswellNat 4451, 2014 CarswellNat 4452 (S.C.C.); and *Lee v. R.*, 2010 TCC 400, 2010 CarswellNat 3586, 2010 CarswellNat 2495 (T.C.C. [Informal Procedure]), at para. 61.
[65] *Daszkiewicz v. R.*, 2016 TCC 44, 2016 CarswellNat 5268, 2016 CarswellNat 306 (T.C.C. [General Procedure]), at para. 34.
[66] *Wajsfeld v. R.*, 2005 TCC 351, 2005 CarswellNat 2219, 2005 CarswellNat 6836 (T.C.C. [General Procedure]), at para. 52.
[67] *Ibid*.

[68] *Sledge v. R.*, 2016 TCC 100, 2016 CarswellNat 1178, 2016 CarswellNat 10352 (T.C.C. [General Procedure]) [*Sledge*], at para. 11.
[69] ITA, *supra* note 1 at subsection 163(3).
[70] *Venne v. R.*, 1984 CarswellNat 210, [1984] C.T.C. 223 (Fed. T.D.) [*Venne*], at para. 40.
[71] *Ibid*.
[72] *Ibid*. at para. 37.
[73] *De Gennaro v. R.*, 2016 TCC 108, 2016 CarswellNat 1519, 2016 CarswellNat 10843 (T.C.C. [General Procedure]) [*De Gennaro*], at para. 63.
[74] *Ibid.* at para. 63.
[75] *Strachan v. R.*, 2015 FCA 60, 2015 CarswellNat 467, 2015 CarswellNat 6413 (F.C.A.) [Strachan], at para. 4.
[76] *Torres v. R.*, 2013 TCC 380, 2013 CarswellNat 4583, 2013 CarswellNat 6300 (T.C.C. [General Procedure]), affirmed 2015 CarswellNat 467, 2015 CarswellNat 6413 (F.C.A.) [*Torres*].
[77] *Ibid*. at subparagraph 65(c).
[78] *Ibid*. at subparagraphs 65(d) and 65(e) in which Justice Miller provides examples of facts that should prompt an inquiry.
[79] *Ibid*. at subparagraph 65(f).
[80] *Strachan*, *supra* note 75.
[81] *Torres*, *supra* note 76 at para. 67.
[82] *De Gennaro*, *supra* note 73 at para. 65.
[83] *Torres*, *supra* note 76 at para. 65.
[84] *Hine v. R.*, 2012 TCC 295, 2012 CarswellNat 3018, 2012 CarswellNat 4092 (T.C.C. [General Procedure]), at para. 26.
[85] *Fourney v. R.*, 2011 TCC 520, 2011 CarswellNat 4734, 2011 CarswellNat 6074 (T.C.C. [General Procedure]), at para. 80.
[86] *897366 Ontario Ltd. v. R.*, 2000 CarswellNat 382, 2000 CarswellNat 4428, [2000] G.S.T.C. 13 (T.C.C. [Informal Procedure]). Note that the section 285 of the *Excise Tax Act* is substantively the same as section 163 of the ITA and the court applies the same legal test to both provisions.
[87] *Sledge*, *supra* note 68 at para. 28.
[88] ITA, *supra* note 1 at para. 162(10.1)(d).
[89] *Ibid*. at para. 162(10.1)(e).
[90] *Ibid*. at para. 162(10.1)(f).
[91] See Thomson Reuters' Practical Insight on Transfer Pricing.
[92] Canada Revenue Agency's Transfer Pricing Review Committee statistics, online at www.canada.ca/en/revenue-agency/services/tax/technical-information/compliance-manuals-policies/transfer-pricing-review-committee.html. .
[93] ITA, *supra* note 1 at para.163.3(2)(a).
[94] *Ibid*. at para. 163.3(2)(b).
[95] *Ibid*. at para. 163.3(3)(a).
[96] *Ibid*. at para. 163.3(3)(b).
[97] *Ibid*. at subsection 163.3(8).
[98] *Ibid*. at para. 163.3(4)(a).
[99] *Ibid*. at para. 163.3(4)(b).
[100] *Ibid*. at para. 163.3(4)(c).
[101] *Ibid*. at subsection 163.3(8).

[102] See the David Sherman's annotated *Practitioner's Income Tax Act*, 63rd ed., notes to subsection 163.2(1), the definition of culpable conduct.
[103] See the David Sherman's annotated *Practitioner's Income Tax Act*, 63rd ed., notes to subsection 163.2, the Agency had issued 119 penalty assessments totaling $322 million of penalties.
[104] *Guindon v. R.*, 2012 TCC 287, 2012 CarswellNat 3708, 2012 CarswellNat 5562 (T.C.C. [General Procedure]), reversed 2013 CarswellNat 1832, 2013 CarswellNat 3428 (F.C.A.), affirmed 2015 CarswellNat 3231, 2015 CarswellNat 3232 (S.C.C.).
[105] *Guindon v. R.*, 2013 FCA 153, 2013 CarswellNat 1832, 2013 CarswellNat 3428 (F.C.A.), affirmed 2015 CarswellNat 3231, 2015 CarswellNat 3232 (S.C.C.).
[106] *Guindon v. R.*, 2015 SCC 41, 2015 CarswellNat 3231, 2015 CarswellNat 3232 (S.C.C.).
[107] *Ploughman v. R.*, 2017 CarswellNat 1819, 2017 TCC 64 (T.C.C.), at para. 64.
[108] *IC-01-1, Third-Party Civil Penalties, September 18, 2001,* at para. 35.
[109] *Ibid.*
[110] ITA, *supra* note 1 at para. 163.2(1).
[111] ITA, *supra* note 1 at para. 237.3(1).
[112] *Ibid.*
[113] See Canada Revenue Agency's Mandatory Disclosure Rules Guidance, *supra* note 53.
[114] The repeated failure to report income penalty under subsection 163(1), the gross-negligence penalty under subsection 163(2), and the third-party penalties under section 163.2.
[115] *C. (R.) v. McDougall*, 2008 SCC 53, 2008 CarswellBC 2041, 2008 CarswellBC 2042 (S.C.C.), at para. 49.
[116] *Corriveau c. R.*, 1998 CarswellNat 2792, 1998 CarswellNat 2602, [1999] 2 C.T.C. 2580 (T.C.C.), at para. 24.
[117] *Farm Business Consultants Inc. v. R.*, 1994 CarswellNat 1107, (*sub nom.* Farm Business Consultants Inc. v. Canada) [1994] 2 C.T.C. 2450 (T.C.C.), at para. 27, affirmed 1996 CarswellNat 1275 (Fed. C.A.).
[118] *Fourney*, *supra* note 85 at para. 80.
[119] *IC00-1R6 – Voluntary Disclosures Program*, at para. 28. (https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic00-1/ic00-1r6-voluntary-disclosures-program.html)
[120] *Ibid.*at para. 20.
[121] *Ibid.*at paras. 13 to 17.
[122] *Ibid.*at para. 14.