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Tax Advisors & Accountants Third-Party Penalties: Civil or Criminal?

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Prior to 1999, the Minister of National Revenue and Canada Revenue Agency (hereinafter jointly referred to as the "CRA") had two legislative tools to severely punish taxpayers, advisors, planners, promoters and preparers i.e., subsection 163(2) and section 239 of the *Income Tax Act* (Canada) (the "Act").

Subsection 163(2) permits the CRA to assess 50 per cent civil gross negligence tax penalties against a taxpayer who knowingly, or under circumstances amounting to gross negligence, made a false statement or omission in his tax return (the "gross negligence penalty"). In these cases, CRA bears a heavy onus of proof to establish, on a balance of probabilities, that the taxpayer's conduct was reprehensible (bordering on criminal behavior) or reckless to justify the imposition of the gross negligence penalty against the taxpayer.

Section 239 provides that the CRA can lay a tax evasion charge in the Criminal Court against the taxpayer, or any other person, who conspired to attempt to willfully evade the payment of tax. In these cases, the CRA bears the highest onus of proof, beyond a reasonable doubt, to establish that the taxpayer or the conspirator attempted to willfully evade the payment of tax. Section 239 enables the CRA to lay tax evasion charges against conspirators such as tax promoters, planners and preparers (a "Third Party") who encourage or help facilitate tax evasion. However, the high onus of proof in these cases makes it difficult for the CRA to secure convictions.

In reviewing the gross negligence penalty and section 239, Parliament decided to expand the legislation to enable the CRA to punish tax advisors, promoters, planners and preparers but to avoid the difficulties of establishing proof beyond a reasonable doubt in the criminal context. In short, Parliament intended to create a civil penalty similar to the gross negligence penalty that would enable the CRA to punish third-parties who advised other taxpayers to submit tax returns that contravened the Act and third-parties that prepared tax returns that contravened the Act. This way, the CRA could punish conspirators using a lower standard of proof which would result in greater success in securing the punishment.

As a result, Parliament enacted subsection 163.2(2) to punish tax advisors and subsection 163.2(4) to punish tax preparers (jointly referred to as "Third-Party Penalties"). Although the courts have held on several occasions that CRA Information Circulars are not the law, the CRA has published Information Circular 01-1 entitled Third-Party Civil Penalties outlining its position related to Third-Party Penalties. Generally speaking, the quantum of these penalties is the sum of the amount of tax that the advisor or preparer attempted to help his client(s) evade and the limit, if any, to the Third-Party Penalties is quite high. In fact, it appears that the quantum of Third-Party Penalties could exceed a penalty imposed under section 239.

The CRA reports that - since section 163.2 was enacted - it has completed its review of 121 cases involving potential Third-Party Penalties and that it has imposed Third-Party Penalties in 71 cases totaling $79 million.

Tax practitioners and commentators have long criticized the Third-Party Penalties on the basis that the nature of the matter is a criminal proceeding disguised as a civil penalty (i.e., it seeks to remedy a societal problem not a private matter) and that the punishment is a true penal consequence (i.e., the quantum of the Third-Party Penalties is so high that it is a penal punishment). If these criticisms are correct, the Third-Party Penalties would engage the protection of section 11 of the Canadian Charter of Rights and Freedoms ("Charter") to guarantee the third-party additional substantive and procedural rights including the right to be presumed innocent. In addition, the application of the Charter and the right to be presumed innocent would raise the CRA's burden of proof to proof beyond a reasonable doubt.

In *Guindon* v. *Her Majesty the Queen,*[1] the Tax Court of Canada (the "Tax Court") had its first opportunity to consider whether the Third-Party Penalties were criminal in nature and resulted in a true penal consequence. Ms. Guindon was a lawyer and a president of a charity that was involved in a charitable donation tax program (the "Tax Shelter"). Although Ms. Guindon was not a tax lawyer and she did not fully review the underlying documents, she provided a legal opinion to support the Tax Shelter. In addition, she signed tax receipts related to the Tax Shelter. The CRA established that the Tax Shelter did not comply with the Act and imposed Third Party Penalties in the amount of $546,747. Ms. Guindon appealed the assessment in the Tax Court.

The Tax Court allowed Ms. Guindon's appeal on the basis that the Third-Party Penalties created a criminal offence. The Tax Court noted that the imposition of Third-Party Penalties does not require that a taxpayer relied on the Third Party's false statement only that the taxpayer could have relied on the false statement. The Tax Court held that this indicates that the Third-Party Penalties act as a public deterrent as opposed to a private disciplinary action and, therefore, the nature of the matter is criminal.

Section 163.2 applies to a Third Party who, by making a false statement, could have induced another person to use that statement for a purpose of the Act. The Third-Party is not the person considered to have acted upon the false statement and, as mentioned earlier, section 163.2 takes aim even at situations where the false statement has not been acted upon by another person. For these reasons, the argument that section 163.2 prescribed a civil penalty as part of a regulatory scheme designed to ensure compliance with the Act is unpersuasive.

Second, the Tax Court held that the Third-Party Penalties constitute a true penal consequence on the basis that the potential quantum of the penalty is so high that it appears to be an attempt to cure a societal wrong as oppose to a private disciplinary action related to a limited activity.

In the case at bar, Ms. Guindon was assessed Third-Party Penalties in the amount of $546,747. This amount was calculated by adding up the amounts of the penalties under subsection 163(2) to which each of the 134 other donors would have been liable. The penalty under subsection 163.2(5) thus has the potential of increasing *ad infinitum* depending on the number of "other persons" involved. As the Appellant submitted, where the penalty is unlimited and is imposed on a Third Party, it seems evident that its purpose is to redress a wrong done to society and consequently ceases to be a purely administrative matter or one of internal discipline.

Post-Guindon

The Tax Court's decision in *Guindon* undermines the CRA's ability to impose Third-Party Penalties and it is the author's position that the decision is correct in law. The CRA reports that 64 cases involving Third-Party Penalties are ongoing. The CRA has advised that it will hold all objections involving Third-Party Penalties in abeyance pending the resolution of *Guindon*. On October 31, 2012, the CRA filed its notice of appeal to *Guindon* in the Federal Court of Appeal. In the meantime, professionals who advise on tax matters should be aware of *Guindon* and its potential impact as it works its way through the Court process.

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[1] 2012 TCC 287 (hereinafter "*Guindon*").