The Civil Penalties – A Half-Dozen Years On

by David Louis, B. Com., J.D., C.A., Tax Partner
Minden Gross LLP, a member of MERITAS Law Firms Worldwide.
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There's an old vaudeville joke that goes something like this: One guy says to the other, "No time to talk, I'm busy keeping the tigers out of Times Square." The other guy says "Don't be silly, there aren't any tigers in Times Square". The first guy says "I'm doing a great job, aren't I?"

More than half a dozen years since our first articles on the civil penalties were written[1], I feel kind of like that guy. As long-standing readers of this column are well aware, we railed about the spectre of a runaway bureaucracy imposing dozens – maybe hundreds - of civil penalty prosecutions. We *kvetched* about the position in which professionals would find themselves: torn between duties/loyalties to clients, and the fear of the big financial penalties inherent in these rules – topped only by the devastating loss of reputation such proceedings might bring.

Years have gone by - and it turns out there have been only a handful of files in which the civil penalties have been raised. Does this mean we were overly alarmist, or is it because of our ranting? I guess I'll never know for sure whether it is we who kept the tigers out of Times Square.

No Nukes (So Far)

The civil penalties were designed to allow the government to attack things like aggressive valuations on art donation schemes, tax opinions that don't hold water, and so on. But a survey of my colleagues (including our Canada-wide Meritas Tax Group) revealed very little sign**[2]** that the CRA has been inclined to use the civil penalties to attack these sorts of schemes in any systematic way**[3]**. The whole point of the civil penalties in this area is that they are like a nuclear weapon; but it doesn't look like the CRA is anxious to drop the bomb. Until it does, these rules will do nothing to deter rough tough promoters.

But meek tax advisors are another story. In recent years, I have found that the practice of many practitioners has changed. Whereas once upon a time, they were willing to go to great lengths to advance their clients' positions, many have become much more cautious. Usually, some gentle probing reveals in short order what they are worried about.

As a lawyer, I am trained to do just about everything in my power to advance a client's position. To an accountant, there should be little difference. The duty to a client is so clear that it only needs to be implied in some of the rules of conduct: the client's interests are paramount. But from the beginning, there was concern that the civil penalties would pit practitioners against their clients.

There are more and more signs that this is coming to pass, and that practitioners are concerned that by "pushing too hard" for a client, they may be putting themselves in harm's way.

It may be the case that many general practitioners have difficulty understanding just what it takes to trigger the penalties. Some practitioners seem to think that, from the standpoint of the civil penalties (as well as opening up the normal reassessment period), any mistake could trigger them.**[4]** While there is, of course, no case law as yet on the civil penalties themselves, the issues are similar to the 50% gross negligence penalty under subsection 163(2). The subsection 163(2) cases usually involve falsifications of expenses, non-reporting of income and the like, rather than "judgmental" matters (such as ill-founded claims for capital gains status or aggressive technical interpretations). What it takes to trigger the civil penalties is indifference to compliance with the Act, or a willful, reckless or wanton disregard for the tax laws. While there has been some waffling on the point over the years, the current Information Circular**[5]** acknowledges that the Department of Finance intended these penalties to apply to "egregious" situations. It goes on to state that the legislation is not intended to apply to differences of interpretations or opinion where there is *bona fide* uncertainty (e.g., the issue is not well-settled in jurisprudence) as opposed to where the position taken is obviously wrong, unreasonable, and/or contrary to well established case law.

If a filing position is tenable, the CRA should not be looking to impose the penalties. Of course, things are never this easy: a possible filing position may be "closer to the line"; the detriment to the client may be only a possibility. A busy practitioner does not have the time or often the training to consider distinctions between ordinary and gross negligence. If practitioners decide to err on the side of self-preservation, can you really blame them? (While I could say that, in view of the paramountcy of client interests, they may be going too far, this sort of "preaching" would be a cheap shot.) Of course, these situations - i.e., involving tricky balancing between a client's welfare and self-preservation - are among the reasons why I opposed the civil penalties so vociferously to begin with.

Box Score

At the moment, I think it is fair to say that, if you are a "decent" practitioner, you should worry as much about being hit by a truck as drawing the penalties. A chat with a CRA official revealed the following cumulative "box score" on the civil penalties:

- penalties applied – 6 files**[6]**;
- ongoing audits – 5 files;
- new cases – no decision as to whether to assess – 3 files;
- assessments rejected – 9 files.

A plugged-in colleague who attended a recent session with government officials on the subject tells me that none of the files recently under review relate to sophisticated plans developed by aggressive tax planners. So far, the civil penalty assessments largely relate to fairly egregious situations where it is difficult to find sympathy with the persons assessed.

That's it. The result of half a dozen years under the system. There is some reason to believe that the CRA will become more aggressive over time. But will the police state I originally feared come to pass? The civil penalty regime hits from the ground up: reading between the lines, I would think that the attacks thus far are focused on pretty low-level practitioners. But what may be emerging is a very different game plan: to strike from the top down, with more and more heat on big firms, perhaps due to pressure on the CRA emanating from south of the border. Just like they go after celebrities, the IRS game plan is to scare off smaller players by showing that they can bring down "big game" with nine-figure reassessments. If this approach comes to Canada – and there are increasing signs that it will – throwing the book at some schmuck for bogus cab receipts may be just a sideshow.

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[1] By my colleague Brian Nichols and I.

[2] There is probably one exception; but I have heard that "bad blood" had a role in how the CRA approached the situation.

[3] Apart from the situation mentioned in the note above, no one was aware of any attempt to impose the civil penalties in situations such as bogus tax opinions, or aggressive but "sophisticated" tax structures.

[4] From this, internal logic might dictate that all accounting must be in accordance with GAAP, even if a Notice to Reader engagement. I do not believe that this is the case.

[5] IC 01-1.

[6] With respect to this item, the CRA referred to it as "preparer penalties". I am not sure that the interpretation should be literal; however, as discussed later, it may be.