The Defence Against Civil Penalties

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PRÉCIS

Par suite de l'entrée en vigueur de loi, le 29 juin 2000, du projet de loi C-25, l'article 163.2, qui traite de la législation sur les nouvelles pénalités administratives, a été ajouté à la Loi de l'impôt sur le revenu du Canada.

Le présent article porte avant tout sur le fait que l'interprétation de la législation sur les pénalités administratives ne doit pas être aussi large que certains l'ont laissé entendre, et ce, bien que sa portée plus étendue qu'il n'est nécessaire pour résoudre le problème perçu par le ministère des Finances. Les auteurs avancent divers arguments qui pourraient restreindre l'application de la législation en question.

Les raisons pour lesquelles le ministère des Finances estime que la législation régissant les pénalités administratives est nécessaire sont exposées brièvement dans l'article et on y précise les abus visés par cette législation. En outre, l'article renferme une description de l'origine législative et des explications sur l'influence de celle-ci sur le libellé de la législation définitive.

Les auteurs donnent un aperçu de la législation, puis analysent l'article 163.2 en détail. Ils décrivent les dispositions qui imposent une responsabilité figurant aux paragraphes 163.2(2) et 163.2(4) et en étudient la portée ainsi que les restrictions. Ils examinent également les éléments des dispositions qui imposent une responsabilité ainsi que le sens de certains des termes utilisés.

Les auteurs analysent la défense de bonne foi, prévue par la législation, contre les dispositions qui imposent une responsabilité et les activités exclues pour lesquelles on ne peut recourir à ce moyen de défense. Ils traitent aussi des dispositions qui jugent que certaines évaluations constituent un faux énoncé. Par la suite, les auteurs passent en revue les dispositions visant les pénalités, traitent de la nature et de la portée des pénalités qui peuvent être imposées et décrivent les activités qui sont exclues de l'application des dispositions punitives.

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ABSTRACT

Bill C-25, which became law on June 29, 2000, added to the Income Tax Act (Canada) section 163.2, which contains the new civil penalties legislation.

The theme of this article is that, although the civil penalties legislation is far broader than is needed to cure the problem perceived by the Department of Finance, it should not be construed as broadly as others have suggested. Throughout the article, the authors provide various arguments that may be used to limit the application of the legislation.

This article outlines the reasons why the Finance department considered the civil penalties legislation to be necessary and describes the abuses at which the legislation was aimed. It also describes the legislative history and explains how that history has influenced the wording of the final legislation.

The authors provide an overview of the legislation and then analyze section 163.2 in detail. The charging provisions contained in subsections 163.2(2) and (4) are described and their scope and limitations are considered. The elements of the charging provisions are analyzed and the meanings of various terms used therein are examined.

The authors analyze the good faith defence to the charging provisions provided by the legislation and the excluded activities to which that defence is not applicable. They also discuss the provisions that deem certain valuations to constitute a false statement. The authors then review the penalty provisions, discuss the nature and extent of the penalties that may be applied, and describe the activities that are excluded from the application of the penalty provisions.

What touches us ourself shall be last serv'd.

Julius Caesar in
Julius Caesar, Act III, Scene I

INTRODUCTION

Few pieces of income tax legislation have generated so much passion as the new civil penalties provisions of section 163.2 of the Income Tax Act.[1] Undoubtedly, such passion arises because the legislation concerns tax advisers personally and the advisers have not followed Julius Caesar's example. A number of commentators discussed this legislation in the months preceding its enactment.[2] However,

1 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act. The new civil penalties legislation was enacted by Bill C-25, An Act To Amend the Income Tax Act, the Excise Tax Act and the Budget Implementation Act, 1999; SC 2000, c. 19; given royal assent June 29, 2000.

2 See, for instance, papers by Brian Nichols, "Civil Penalties for Third Parties," in *1999 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 1999), tab 1; Werner H.G. Heinrich, "The

amendments were incorporated up to completion of second reading in the House of Commons, and these earlier commentators did not have the benefit of the final legislation when they prepared their papers. Moreover, their papers were advocacy pieces designed to persuade the Department of Finance to make changes to the legislation before it was passed into law.[3]

It is not inappropriate for tax advisers to look out for their own interests. Those familiar with Shakespeare will realize that the quote that begins this article is soon followed by Caesar's famous last words "*Et tu, Brute?* Then fall, Caesar!", from which we may conclude that a high price may be paid for placing the interests of others ahead of one's own. In the case of tax advisers, that moment has passed. The legislation has been enacted, and there is little likelihood that significant changes will be made to it in the near future. It is now appropriate, therefore, to turn our attention away from advocating changes to considering the impact of the civil penalties provisions.[4]

The purpose of this article is threefold:

- First, the article will discuss the new provisions in the context of tax practice: what the legislation states, in its final form; how it will affect the everyday

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Tax Advisor at Risk: Civil Penalties and Criminal Sanctions," in *1999 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 1999), tab 11; and Carman R. McNary, "The New Civil Penalty Provisions: Professional Liability for Culpable Conduct," in *2000 Prairie Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2000), tab 4. In addition, David Louis and Brian Nichols co-authored several articles that appeared in *Tax Topics*: "Beyond the 'Accountant's Fine,'" *Tax Topics*, no. 1437 (Toronto: CCH Canadian, September 23, 1999), 1-3; "Beyond the 'Accountant's Fine': Part II—The Tax Law from Hell," *Tax Topics*, no. 1438 (Toronto: CCH Canadian, September 30, 1999), 1-3; and "Civil Penalties for Tax Advisors—The Nightmare Continues," *Tax Topics*, no. 1457 (Toronto: CCH Canadian, February 10, 2000), 1-3.

3 See Nichols, supra footnote 2. This comment is not intended to be pejorative. These articles, together with submissions from professional bodies, including the CICA/CBA Joint Committee on Taxation (herein referred to as "the joint committee") and the Certified General Accountants Association, and from individual practitioners, have resulted in a number of amendments to the legislation since it was first proposed in the budget of February 1999.

4 Some of the submissions referred to in footnote 3, supra, suggested that the legislation violated the Charter of Rights and Freedoms because it was criminal in nature by virtue of the penalties but did not provide the safeguards accompanying criminal legislation. This article is restricted to an interpretation of the legislation as enacted and assumes the validity of the legislation.

Although we have had the benefit of reviewing the final legislation, the topic will continue to evolve. In Finance Canada, *News Release*, no. 99-076, September 10, 1999, which accompanied the draft legislation, the Department of Finance announced that there would be a consultation process with the CCRA about the enforcement of the legislation. This consultation process produced a draft information circular, IC 01-1, dated January 12, 2001. Undoubtedly, the positions of the CCRA taken in the circular will spark renewed debate. This article was completed before the draft became available, and we have not rewritten the article to deal with the issues analyzed by the CCRA in the draft. Undoubtedly, amendments will be made to the circular before it is issued in final form. We anticipate that there will then be a dormant period until the first cases involving the civil penalties legislation proceed to court.

activities of tax advisers; and what legal defences are available if a tax adviser is assessed under section 163.2.

• Second, since courts are always interested in the background to legislation as an aid to interpretation,[5] this article will constitute a contemporary record of the reasons for the use of some of the language in the civil penalties provisions.

• Finally, courts consider published articles in order to formulate their views on the meaning of legislation,[6] and we wish to put on record our views as to how the civil penalties provisions should be interpreted.

The other papers that have been considered in this article[7] have taken the position that the language in the legislation is very broad and gives the Canada Customs and Revenue Agency ("the CCRA") significant powers with which to curtail the activities of tax advisers. We accept that the legislation could be interpreted as broadly as others suggest. The recent case of *Findlay v. The Queen*,[8] discussed immediately below, supports their fears and affords a chilling example of what may happen to professionals pursuant to a section 163.2 assessment if the courts do give broad meaning to the language. However, we do not think that the world of aggressive but careful tax planning ended on June 29, 2000. We are of the view that there is another aspect to the legislation that has not been addressed in the other papers.[9] This article considers the arguments that a representative of an adviser would make to the CCRA and to the courts in order to limit the scope of the legislation.[10] We do not present a defence of the new provisions; in our view, they cast a far wider net than is needed to cure the problem that the auditor general foresaw[11] and the problem at which the Department of Finance was aiming.[12] Instead, we outline our views on both the weaknesses and the limitations of the legislation.

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5 See, for example, *Will-Kare Paving & Contracting Limited v. The Queen*, 2000 DTC 6467 (SCC) (discussed in the Current Cases feature in this issue of the journal).

6 See the Federal Court of Appeal's decision in *The Queen v. Shell Canada Limited*, 98 DTC 6177, at 6187, where Mr. Justice Linden for the court refers to David G. Broadhurst, "Tax Considerations for Hedging Transactions," in *Taxation of Financial Transactions: Effective Strategies for Corporate Financing* (Mississauga, Ont.: Insight Press, 1991), article I, and Stephen S. Ruby, "Hedging Transactions," ibid., article VII.

7 Supra footnote 2.

8 2000 DTC 6345 (FCA), rev'g. 97 DTC 1149 (TCC).

9 Supra footnote 2.

10 We have described the earlier papers (ibid.) as advocacy pieces in that they recommended changes to the legislation. However, our own article could well be characterized as an advocacy piece in that it suggests approaches to limit the application of the legislation.

11 As discussed below, the basis for the legislation was Canada, *Report of the Auditor General of Canada to the House of Commons* (Ottawa: Public Works and Government Services, May 1996).

12 Brian Carr was a member of the joint committee and in that capacity had numerous informal discussions with officials of the department.

In *Findlay*, the taxpayer made an election pursuant to section 85 on the transfer of business assets to a corporation and generated some capital gains. In reviewing the taxpayer's 1991 personal income tax return, the CCRA noticed that the sum of $135,000, identified as capital gains generated by the transfer, was not reported at line 127 of the return. The taxpayer had retained an outside firm of experts to prepare his books of account and his income tax returns. This firm's computer program had an error in that the corporate information was not matched with the individual's. As a result, the taxpayer's capital gains were not reported. The minister assessed Mr. Findlay under subsection 163(2) of the Act on the basis that he had omitted the capital gains as a result of his own gross negligence, and imposed penalties. In dismissing the taxpayer's appeal,[13] the Tax Court of Canada concluded that although Mr. Findlay's own conduct had not amounted to gross negligence, the outside firm's gross negligence was attributable to him. As a result, the penalties imposed by the minister were affirmed. The taxpayer appealed to the Federal Court of Appeal.

In allowing the taxpayer's appeal, the Federal Court concluded that the minister had failed to show, on a balance of probabilities, that the taxpayer had knowledge of the omission of the capital gains by the outside experts but had done nothing about it. Mr. Findlay was able to avoid a charge of gross negligence by transferring culpability to his advisers. The *Findlay* case is unusual in that although the court concluded that the advisers had been grossly negligent, the advisers were not before the court. It may well be that had the advisers been before the court, they could have led evidence to exculpate themselves.

The lesson of *Findlay* in the present context is that if a court applies the same reasoning in a similar factual situation to the new civil penalties legislation, the outside experts may be subject to penalties under subsection 163.2(4).

BACKGROUND

Reasons for the Legislation

The reasons for the civil penalties legislation have been described elsewhere[14] and will be summarized here for convenience of reference only.

Third-party penalties were first considered by the CCRA in 1992. The CCRA had been finding tax promotions with inflated asset values and business plans that were never carried out and, it appeared, were never intended to be carried out.[15]

13 Supra footnote 8.

14 In particular, see the transcript of Jerry Lalonde's comments in Brian R. Carr, Jerry Lalonde, and Ralph Neville, "The New Civil Penalty Proposals," in *Report of Proceedings of the Fifty-First Tax Conference*, 1999 Conference Report (Toronto: Canadian Tax Foundation, 2000), 18:1-22, at 18:2-3.

15 Backgrounder prepared by the CCRA entitled, "Background Information on Third Party Penalty," used in the CCRA's consultations internally and with external groups on the administration of the third-party civil penalties (July 2000).

The 1996 auditor general's report reviewed the CCRA's program to combat tax avoidance. Among other recommendations, the auditor general suggested that the CCRA seek an amendment that would impose civil penalties on those who promoted abusive tax shelters. In February 1997, the House of Commons Standing Committee on Public Accounts instructed the CCRA and the Department of Finance to take prompt steps to introduce penalties aimed at deterring promoters of abusive tax shelters. The matter was referred to the Technical Committee on Business Taxation, which, in 1998, recommended that the tax laws be revised to provide civil penalties against those who knowingly, or in circumstances amounting to gross negligence, made false statements or omissions in respect of another person's tax matters.[16] The February 16, 1999 budget proposed that civil penalties should be assessed against persons who knowingly, or in circumstances amounting to gross negligence, made false statements in tax-planning arrangements, or who counselled or assisted in the filing of false tax returns. Draft legislation was released on September 10, 1999, and a revised draft was issued on December 7, 1999. The legislation continued to be amended as it moved through the legislative process. It received royal assent as part of Bill C-25 on June 29, 2000.

Intent of the Legislation

As indicated in informal discussions with members of the Department of Finance,[17] the legislation is aimed at two main sources of abuse: tax promoters who devise schemes that do not work[18] but result in unwarranted claims for deductions, and tax return preparers who manufacture deductions.

A prime example of the first kind of abuse, in the view of the Department of Finance, was the case of *Global Communications Limited v. The Queen*.[19] The taxpayer, Global Communications Limited ("Global"), purchased seismic data for $15 million. Of that amount, $1.8 million was paid in cash. The balance of $13.2 million was secured by a limited recourse promissory note. Global proceeded to deduct the full purchase price from its income over its 1991 and 1992 taxation years on the basis that the amount qualified as a Canadian exploration expense (CEE) within the meaning of subparagraph 66.1(6)(a)(i) of the Act as it read in those years.[20] On reassessment, the minister disallowed the deduction in its entirety.

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16 Canada, *Report of the Technical Committee on Business Taxation* (Ottawa: Department of Finance, April 1998), 10.12.

17 See supra footnote 12.

18 The Department of Finance was not concerned with aggressive tax plans that were technically correct. It was concerned with tax plans that were flawed but nevertheless resulted in investors' claiming deductions to which they were not entitled.

19 99 DTC 5377 (FCA), aff'g. 97 DTC 1293 (TCC).

20 Paragraph 66.1(6)(a) read, in part, as follows:

> "Canadian exploration expense" of a taxpayer means any expense incurred after May 6, 1974 that is

At the Tax Court of Canada, His Honour Judge Beaubier held that Global had incurred a CEE for the $1.8 million that it had paid in cash but had not incurred any CEE with respect to the amount that it had paid by way of a limited recourse promissory note.

The taxpayer appealed to the Federal Court of Appeal, alleging that the entire $15 million in issue was deductible. The minister cross-appealed, seeking to affirm his reassessments. Mr. Justice Robertson for the court held that the taxpayer was not entitled to any deduction. The court found that seismic data purchased for the purpose of resale or licensing did not qualify as a CEE within the meaning of subparagraph 66.1(6)(a)(i), because it did not satisfy the purpose test referred to in the subparagraph. Alternatively, Mr. Justice Robertson stated that if the activities of Global satisfied the purpose test, Global was limited to a CEE deduction of $1.8 million. One of the reasons that he gave for reaching this alternative conclusion was that Global had failed to establish that the seismic data had a fair market value greater than the cash amount.

The experts for Global[21] gave opinions that the fair market value of the seismic data purchased by Global was between $15 million and $19 million. On the same day that the transaction was entered into, the data, together with an additional 1,450 kilometres of seismic data, were sold in an arm's-length transaction for $2 million plus the right to 50 percent of all licensing revenue for the next three years. According to Mr. Justice Robertson's judgment, during oral argument it was conceded that the licensing revenue was not of critical significance, since no one was under any obligation to generate such revenue. For Mr. Justice Robertson, the fact that the licensing revenue actually received by Global over a five-year period was only $2.7 million was significant. Mr. Justice Robertson wondered how the "so-called" experts arrived at a fair market value for the data of $15 to $19 million and stated that Global's appraisers were not prepared to look at the price paid for seismic data on the open market. According to Mr. Justice Robertson, appraisals that ignore cash transactions are simply self-serving opinions designed to inflate the value of seismic data.[22] Mr. Justice Robertson further stated:

> At the end of the day, it is understandable that the Minister would characterize the transactions in question as a "scam," as distinguished from a "sham." A sham involves deceit on the part of a taxpayer, that is, conduct intended to mislead the Minister as to the true state of affairs. In other words, the documents say one thing

> any expense including a geological, geophysical or geochemical expense incurred by him (other than an expense incurred in drilling or completing an oil or gas well or in building a temporary access road to, or preparing a site in respect of, any such well) for the purpose of determining the existence, location, extent or quality of an accumulation of petroleum or natural gas (other than a mineral resource) in Canada.

21 *Global*, supra footnote 19, at 5386 (FCA), states that three experts were retained before the purchase, and a fourth at trial.

22 Ibid., at 5385.

> while the taxpayer does another. In the present case, the documentation does not seek to mislead the minister, but only to tax his gullibility. It is one thing for taxpayers to arrange their affairs so as to move a tax loss from one related company to another, as in *Stubart Investments Ltd. v. The Queen*. . . . It is quite another to create a market place which would not exist but for inflated values attached to a commodity which is nothing more than a highly leveraged tax deduction.[23]

It was the Department of Finance's view of *Global* that valuators were giving opinions based on assumptions provided to them by promoters that had no basis in fact and that promoters were selling deals based on these valuation opinions. According to the department, the valuators knew or should have known that the assumptions were groundless and the promoters knew or should have known that the valuations were wrong because they were based on assumptions that were groundless. In the department's view, each of the valuator and the promoter was pointing to the other and saying, "I can rely on him because he has given me an opinion," whereas each knew or ought to have known that the opinion that was provided was without foundation.[24]

What concerned the Department of Finance most about the *Global* case was that it involved the participation of persons who were, in the department's view, significant players. Global is a well-known Canadian broadcasting corporation, and the advisers who put the deal together were members of major law firms. Before *Global*, according to the Department of Finance, tax advisers had asserted that schemes that were gimmicks and that had no legal or factual foundation were developed and sold only by fringe players, not by the tax advisers in the major legal and accounting firms. Consequently, third-party civil penalties were not required. It was the *Global* case that convinced the Department of Finance that such assertions by the tax community were incorrect and that appropriate third-party civil penalty legislation was needed to cure the abuses.

The second source of abuse that the Department of Finance was trying to eliminate consisted of situations in which tax return preparers would build practices by advising clients to claim deductions to which they were not entitled. A simple example would be advising a client to claim a deduction of 100 percent of expenses incurred in operating a motor vehicle used in a business despite significant personal use of the vehicle. The preparer would rely on the "audit lottery," whereby only a small percentage of individual taxpayers would be audited in any given year. The preparer would gain a reputation for being able to reduce income, where other preparers were unable to do so, simply by encouraging clients to claim unsupportable deductions.

23 Ibid., at 5386.

24 See the transcript of Brian Carr's comments, supra footnote 14, at 18:21.

Legislative History

Resolution 12 of the notice of ways and means motion that introduced the civil penalties legislation was aimed at two activities, planning and reporting.[25] While the February 1999 budget papers stated that there were two separate penalties,[26] neither resolution 12 nor the subsequent legislation so neatly categorizes the two penalties.

The budget proposals were criticized even before they were turned into draft legislation. The Canadian Institute of Chartered Accountants (CICA) objected to the term "gross negligence" used in resolution 12.[27] As discussed below, the concept of negligence requires a duty of care to someone, and the CICA was concerned that their members would owe that duty to the CCRA. The CICA was also concerned that the term "gross negligence" would be given an ambulatory and not a static meaning, and that its meaning would be modified by subsequent non-tax jurisprudence.[28] Apparently, this concern was based on section 10 of the Interpretation Act,[29] which reads:

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25 Such phraseology will be used to refer to the penalty offences in subsections 163.2(2) and (4) respectively, notwithstanding the overlapping wording of the two subsections.

26 The following extracts are taken from Canada, Department of Finance, 1999 Budget, The Budget Plan, February 16, 1999, 205-6:

> The budget proposes to apply civil penalties to third parties that make false statements or omissions in relation to tax matters. In particular, two new penalties are proposed.
>
> Tax shelter and other tax planning arrangements
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> This penalty will apply to a person who plans, promotes or sells an arrangement that the person knows or would have known, but for circumstances amounting to gross negligence, includes a false statement or omission that may be used for tax purposes. This penalty also will apply to a person who provides false information for use in an arrangement. The penalty will be the greater of $1,000 and 100 per cent of the gross revenue derived by the person in respect of the arrangement. . . .
>
> Advising or participating in a false filing
>
> This penalty will apply to a person who makes (or participates in the making of) a statement or omission that the person knows or would have known, but for circumstances amounting to gross negligence, is a false statement or omission that may be used for tax purposes by or on behalf of another person in a return, form, certificate, statement or answer filed or made by or on behalf of that other person. In such circumstances, the penalty will be the greater of $1,000 and 50 per cent of the amount of tax sought to be avoided or refunded.

27 See the transcript of Jerry Lalonde's comments, supra footnote 14, at 18:5.

28 If a static interpretation were given, the meaning of gross negligence would be the meaning at the time the legislation became law. If an ambulatory approach were applied, the meaning of gross negligence would be the meaning at the time that the relevant case was decided, and subsequent cases interpreting the meaning of gross negligence outside the context of the Act would influence the meaning given to it for purposes of the Act.

29 RSC 1985, c. I-21, as amended.

> The law shall be considered as always speaking, and where a matter or thing is expressed in the present tense, it shall be applied to the circumstances as they arise, so that effect may be given to the enactment according to its true spirit, intent and meaning.

As a result of the CICA's criticism, when the draft legislation was introduced, it used the term "culpable conduct" instead of "gross negligence."[30]

The CICA also made representations in which it expressed concern that its members who prepared returns for individuals were frequently presented with a shoebox full of receipts close to the filing deadline and that those tax preparers could not possibly question the appropriateness of every receipt presented to them. These representations resulted in the insertion of the good faith defence in subsection 163.2(6).

When the draft legislation was released, it was criticized on, inter alia, the following technical bases:

- there was an overlap of subsections 163.2(2) and (4), which dealt ostensibly with planning and reporting, respectively;[31]
- the good faith defence did not extend to planning activities;
- there was no limitation on the quantum of penalties;
- employees of taxpayers were subject to the provisions;
- a lawyer would be subject to the solicitor-client privilege rule and would be unable to defend himself or herself;[32] and
- the CCRA would use the legislation as a threat so that the adviser would likely "encourage" the client to settle a reassessment, and a wedge would be driven between the professional adviser and the client.

The legislation as initially drafted treated all tax planning in the same fashion, although, ostensibly, the purpose of the legislation was to target advisers who proposed aggressive tax planning that did not work and tax preparers who counselled false reporting. The draft language was consequently criticized as being far broader than was needed to accomplish these objectives.

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30 The legislation has been criticized on the basis that "culpable conduct" has essentially the same meaning as "gross negligence." In particular, observers have commented that the meaning of culpable conduct was derived from statements made in *Venne v. The Queen*, 84 DTC 6247 (FCTD), and *Malleck v. The Queen*, 98 DTC 1019 (TCC), which considered the meaning of gross negligence in subsection 163(2); see, for example, Nichols, supra footnote 2, at 14-15. Also, see the discussion later in this article beginning at footnote 116 and the accompanying text.

31 See supra footnote 25 and the accompanying text.

32 This particular issue has been hotly debated. However, it deserves discussion in a separate article and will not be considered here. As stated in footnote 4, supra, this article is confined to an interpretation of the legislation.

Finally, the draft legislation was criticized as being unnecessary.[33]

While some of these concerns have been addressed in the final legislation, many remain.

OVERVIEW OF THE LEGISLATION

Subsections 163.2(2) and (4) define the civil penalty offences. These penalty provisions apply to a person who advises or participates in the making of a false statement or omission in relation to tax matters that could be used by another person for a purpose of the Act. For the purposes of section 163.2, a partnership is a person.

In order for subsection 163.2(2) to apply to a person, the person must make or furnish, participate in the making of, or cause another person to make or furnish, a statement. The person must know that the statement is a false statement that could be used by another person for a purpose of the Act, or would reasonably be expected to know, but for circumstances amounting to culpable conduct, that the statement is a false statement that could be so used.

In order for subsection 163.2(4) to apply to a person, the person must make, or participate in, assent to, or acquiesce in the making of, a statement. The statement must be made to, or by or on behalf of, another person. The person must know that the statement is a false statement that could be used by or on behalf of the other person for a purpose of the Act, or would reasonably be expected to know, but for circumstances amounting to culpable conduct, that the statement is a false statement that could be so used.

Although the provisions of subsections 163.2(2) and (4) provide for a substantial overlap, it is the CCRA's view that subsection 163.2(2) applies to planning and valuation activities and subsection 163.2(4) applies to compliance activities.[34] The basis for this view is in the wording of subsections 163.2(3) and (5), which provide for the quantum of the penalties. Subsection 163.2(3), which

33 When comments were made about the broad nature of the legislation to officials of the Department of Finance, they said that they wanted the legislation to challenge only the most egregious situations. The members of the joint committee pointed out that section 239 was already available to the department for those situations. The Finance officials rejoined that because section 239 is criminal in nature, it is very difficult to obtain convictions under it. In effect, section 163.2 was implemented to allow the CCRA to penalize persons in appropriate circumstances by allowing it to apply the balance of probabilities test in civil cases instead of the beyond a reasonable doubt test in section 239, and to obtain the advantage of the procedures available to it in civil proceedings. For example, in criminal proceedings, the defendant has no obligation to testify. If a person were reassessed pursuant to section 163.2, that person would be obliged to submit to an examination for discovery and could be compelled to testify in court.

34 This comment is based on informal discussions with CCRA officials as part of the consultation process referred to in footnote 4, supra.

provides the quantum of the penalty for an offence under subsection 163.2(2), refers to a planning activity or a valuation activity. Subsection 163.2(5), which provides for the quantum of the penalty for an offence under subsection 163.2(4), refers to the statement in a return.

The February 1999 budget[35] contemplated that a tax adviser would be subject to a penalty if he or she devised and promoted a tax scheme that did not technically work or counselled false reporting. By virtue of the wording of subsections 163.2(2) and (4), a tax professional may be subject to a penalty if he or she does not prevent a taxpayer from implementing a flawed plan or from filing a false return. We have therefore moved from the situation contemplated in the February 1999 budget in which the tax adviser may be subject to a penalty if he or she is a protagonist to one in which the professional may be subject to a penalty if he or she is not a good enough police officer.

The person referred to in subsections 163.2(2) and (4) ("the adviser") does not act in circumstances amounting to culpable conduct when he or she relies in good faith on information provided to him or her by or on behalf of the other person, or when, because of such reliance, the adviser fails to verify, investigate, or correct the information.[36] This good faith defence does not apply when the adviser makes, or participates in, assents to, or acquiesces in the making of, a statement in the course of an "excluded activity."[37]

Two or more false statements made or furnished by a person in the course of one or more planning activities, or in the course of a valuation activity in respect of a single arrangement, constitutes one false statement for the purpose of applying the penalty in subsection 163.2(2).[38] Such treatment does not apply for purposes of subsections 163.2(4) and (5).[39]

If the stated value of a property or of a service falls outside a prescribed range, the statement of value made by a person who opined as to the value of the property or service, or by a person in the course of an excluded activity, is deemed to be a false statement that the person could reasonably be expected to know, but for circumstances amounting to culpable conduct, was a false statement.[40] This deeming provision does not apply to a person in respect of a statement as to the value of the property or service if the person establishes that the stated value was reasonable in the circumstances, the statement was made in good faith, and, where applicable, the statement was not based on one or more assumptions such

35 Supra footnote 26.

36 Subsection 163.2(6).

37 Subsection 163.2(7).

38 Subsection 163.2(8).

39 Ibid.

40 Subsection 163.2(10).

that the person knew, or would reasonably be expected to know, but for circumstances amounting to culpable conduct, that the assumptions were unreasonable or misleading in the circumstances.[41]

A person providing clerical services (other than bookkeeping services) or secretarial services is not subject to penalties.[42]

Employees of the other person referred to in subsections 163.2(2) and (4) (that is, the person who can use the statement in a tax return) are not subject to penalties, and the conduct of the employee is deemed to be that of the other person for the purpose of subsection 163(2).[43] This exception does not apply to employees who are not employees of the other person; for example, it does not apply to employees of the parent corporation or subsidiary corporations of the other person.

DETAILED ANALYSIS

Interpretative Approach

Some of the other commentators who have reviewed the civil penalties legislation[44] have adopted a literal interpretation[45] and have given the words their broadest possible meaning. It is not a foregone conclusion that courts will interpret the legislation in this fashion.[46] There are a number of techniques that courts use to interpret legislation. Before the civil penalties legislation can be applied in a particular situation, one of these techniques must be adopted.

A number of papers and articles have been recently published on the theme of interpreting the Act. This article is not another treatise on statutory interpretation. Authors such as Brian Arnold, David Duff, Joel Nitikman, Derek Alty, and

41 Subsection 163.2(11).

42 Subsection 163.2(9).

43 Subsection 163.2(15).

44 See, in particular, Nichols, supra footnote 2.

45 As discussed below, commentators on statutory interpretation do not agree on a single correct approach. Moreover, they use their own definitions of the available interpretative approaches, and these may differ in certain essential elements; see, for example, infra footnotes 48 and 53, which present contrasting explanations of "strict construction" and "strict interpretation."

46 We have already conceded that courts might adopt a literal interpretation: see the discussion of *Findlay* in the text accompanying footnote 8, supra. It is our view, for the reasons discussed below, that they should not do so. It must be admitted that while much has been made in other articles, and will be made in this article, about the imprecise wording of subsections 163.2(2) and (4), most cases will be decided on the facts. The court will simply hear all the evidence and determine whether an adviser knew that a statement was false or would reasonably be expected to have known that a statement was false, but for circumstances amounting to culpable conduct. Only infrequently will the cases be decided on the basis of the interpretation of the legislation.

Lisa Philipps have thoroughly canvassed the landscape.[47] We cannot in two or three pages appear as *deus ex machina* and advise how the courts will or should interpret the legislative provisions. The proper manner in which to interpret tax legislation is left to a battle between Ms Philipps and Messrs. Duff and Arnold on one side and Messrs. Nitikman and Alty on the other.

According to David Duff, the courts have referred to four main doctrines to interpret the Act:

1) strict construction,[48]
2) purposive interpretation,[49]
3) the plain meaning rule,[50] and
4) the words-in-total-context approach.[51]

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47 Brian J. Arnold, "Statutory Interpretation: Some Thoughts on Plain Meaning," in *Report of Proceedings of the Fiftieth Tax Conference*, 1998 Conference Report (Toronto: Canadian Tax Foundation, 1999), 6:1-36; David G. Duff, "Interpreting the Income Tax Act—Part 1: Interpretive Doctrines" (1999), vol. 47, no. 3 *Canadian Tax Journal* 464-533; Joel Nitikman and Derek Alty, "Some Thoughts on Statutory Interpretation in Canadian Tax Law—A Reply to Brian Arnold" (2000), vol. 20, no. 20 *Tax Notes International* 2185-2223; and Lisa Philipps, "The Supreme Court of Canada's Tax Jurisprudence: What's Wrong with the Rule of Law" (2000), vol. 79, no. 2 *The Canadian Bar Review* 120-44. Normally, the theory of statutory interpretation would not be included in an article analyzing the provisions of a section of the Act. It would be assumed that the reader would be familiar with the various approaches to statutory interpretation. However, many (although certainly not all) of the deficiencies in the legislation outlined in the advocacy articles arise because these articles have interpreted the legislation in a literal fashion and have given all the words a very broad meaning. Some (but certainly not all) of the difficulties presented by the legislation may disappear if the courts take, for example, a purposive approach to the legislation.

48 Duff, supra footnote 47, at 469, defines the "strict construction" approach as follows: "For many years, the dominant approach to the interpretation of tax legislation in Canada involved strict construction, according to which statutory language was construed literally, ambiguities in taxing provisions were resolved in favour of the taxpayer, and ambiguities in provisions setting out deductions or exemptions were resolved against the taxpayer."

49 Duff, ibid., at 486, defines the "purposive interpretation" approach as follows: "In contrast to strict construction, which stressed the literal meaning of the statutory text and resolved ambiguities according to rigid presumptions, purposive interpretation emphasizes the reasons for which the statutory text was enacted and the objectives at which it aims, and interprets the text in light of these reasons and objectives."

50 Duff, ibid., at 504, explains "the plain meaning rule" as follows: "While purposive interpretation begins with the objectives underlying the statutory text and the reasons for which it was enacted, and interprets the text in light of these objectives and reasons, the plain meaning approach to statutory interpretation begins with the words of the text, which are to be given their ordinary or literal meaning unless they are ambiguous, in which case the court may then consider 'the scheme of the Act, the object of the Act, and the intention of Parliament' in order to resolve the ambiguity."

51 Duff, ibid., at 518, explains the "words-in-total-context" approach as follows: "Unlike purposive interpretation, which considers 'the scheme of the Act, the object of the Act, and the intention

David Duff introduces his article as follows:

> During the last 15 years, the Supreme Court of Canada has reconsidered—but as yet not resolved—the manner in which the courts ought to interpret the Income Tax Act. Until *Stubart Investments Limited v. The Queen*, the prevailing rule in Canada was that tax statutes should be strictly construed. In *Stubart*, the Supreme Court of Canada rejected this traditional rule, favouring instead the "modern rule" affirmed in Driedger's *Construction of Statutes*, according to which the "words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament."
>
> In the years since *Stubart*, the court has struggled both with the doctrinal implications of this decision and with the interpretative principles by which the Act ought to be understood. In some cases, the court has emphasized "the scheme of the Act, the object of the Act, and the intention of Parliament," adopting an explicitly "purposive" or "teleological" approach to its interpretation. In other decisions, the court has favoured a "plain meaning rule" according to which "unambiguous" statutory provisions should be construed without regard to other indications of statutory meaning. Most recently, the court has returned to the so-called words-in-total-context approach suggested by the passage quoted above, concluding that "in order to determine the clear and plain meaning of the statute it is always appropriate to consider the scheme of the Act, the object of the Act, and the intention of Parliament."[52]

Brian Arnold categorizes the interpretative approaches as

1) strict interpretation,[53]
2) the modern rule,[54] and

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of Parliament' to be the key elements of statutory meaning, and the plain meaning rule, which regards 'the words of the Act' alone as the primary constituent of statutory meaning, the words-in-total-context approach affirms a more pragmatic view, according to which the meaning of a statutory provision is best understood, as Driedger explained, by reading the words of the provision 'in their entire context . . . harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.' While the words of the Act are central to this approach, they are read not literally, as strict construction and the plain meaning rule suggest, but contextually in light of the statutory scheme, statutory purposes, and legislative intentions."

52 Ibid., at 467-68.

53 Arnold, supra footnote 47, at 6:15-16, defines "strict interpretation" as follows: "Strict interpretation means that the words in question should be given their plain, ordinary meaning. If the meaning of the words is clear, courts need not consider the statutory context in which the words appear or the legislative purpose. Further, it is irrelevant whether the results of strict interpretation based on the plain meaning of the words are reasonable. If the plain, ordinary meaning of the words is unclear because the meaning is vague or ambiguous, courts may consider the context or purpose to determine the meaning or they may resort to various presumptions, such as the presumption that ambiguity should be resolved in favour of the taxpayer."

54 Arnold, ibid., at 6:16, defines "the modern rule" as follows: "The modern rule is the approach to statutory interpretation endorsed by the Supreme Court in the *Stubart* case in 1984. It requires courts to establish the meaning of statutory language by reference to the ordinary

3) the contextual approach.[55]

Arnold comments that during the 1990s, the Supreme Court of Canada's statements about statutory interpretation have been inconsistent and confusing.[56] According to Arnold, the judges claim to be using a strict or plain meaning approach, although they use the term "plain meaning" without precision to mean anything from strict to purposive interpretation.[57]

It is the thesis of Lisa Philipps that regardless of what the Supreme Court of Canada says, it still applies a strict construction approach.[58] She criticizes the court for so doing and urges it to take a more liberal or interventionist approach in the future in order to stop what she considers inappropriate tax avoidance.[59]

In contrast to the other three authors, the thesis of Joel Nitikman and Derek Alty is as follows:

> From a review of the applicable case law, three distinct approaches to interpreting a taxing statute can be discerned: the *strict* (also sometimes referred to as the *literal*) approach; the *plain meaning* (also sometimes variously called the *contextual* or *words-in-context*) approach; and the *purposive* (also sometimes called the *object and spirit* or *teleological* or *liberal*) approach. Professor Arnold's main thesis is that the purposive approach is the correct approach in every instance. Our main thesis is that the plain meaning approach is the correct approach of first instance,

meaning of the words in the context of the entire statute and in the light of its purpose. The weight accorded to each element depends on each particular case, but no element can be disregarded. Context and purpose can be used to show that the meaning of words that appear to be clear are [sic] actually not so clear. In contrast, under strict interpretation, if the meaning of the words appears initially to be clear, the interpretative process ends. The modern approach is sometimes referred to as the purposive approach. This usage is inappropriate, however, because it suggests that legislative purpose should be the primary determinant of meaning."

55 Arnold, ibid., at 6:17, defines the "contextual" approach as follows: "Under a contextual approach, the meaning of the words is determined in the context of the statute. Legislative purpose is not considered unless the meaning of the words construed contextually is unclear."

56 Ibid., at 6:15.

57 Ibid.

58 Philipps, supra footnote 47, at 132-34, discusses the various definitions of "strict construction" and settles on the one used in the English House of Lords decision in *Partington v. The Attorney General* (1869), LR 4 HL 100, at 122, as being one of the most often cited expressions of the strict construction rule in Canadian tax law: "[A]s I understand the principle of all fiscal legislation, it is this: if the person sought to be taxed comes within the letter of the law he must be taxed however great the hardship may appear to the judicial mind to be. On the other hand, if the crown seeking to recover the tax cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be, admissible, in any statute, what is called an equitable construction, certainly such a construction, is not admissible in a taxing statute, where you can simply adhere to the words of the statute."

59 See Philipps, ibid., at 143.

> that the purposive approach should be used if and only if the plain meaning approach has failed to answer the issue.[60]

All of the foregoing articles presume that aggressive tax planners are better off with a plain meaning or strict construction interpretation because such interpretation permits taxpayers to carefully plan around the words of the statute.[61]

The recent case of *Will-Kare Paving & Contracting Limited v. The Queen*[62] indicates the difficulty of trying to determine in advance exactly what approach a court will take in interpreting legislation. In *Will-Kare*, the appellant taxpayer operated a paving business. It constructed its own asphalt plant, anticipating that the plant would allow it to bid on larger contracts and that third-party sales of excess production would make the plant economically feasible. In the taxation years in question, approximately 75 percent of the appellant's asphalt output was supplied to customers pursuant to contracts for work and materials. The remaining 25 percent was sold to third parties. The appellant included the plant in class 39 of schedule II of the regulations to the Act, claiming that the plant was property used primarily in the manufacturing and processing of goods for sale. This classification allowed the taxpayer to claim accelerated capital cost allowance and an investment tax credit within the meaning of subsection 127(5), since the plant would be qualified property within the meaning of subsection 127(9). The minister took the position that the plant was not used primarily for the manufacturing or processing of goods for sale and therefore was included in class 8. The issue in dispute was whether asphalt, which became the property of a customer by virtue of contracts for work and materials, was sold to Will-Kare's customers.

In a 4:3 decision, the Supreme Court of Canada denied the appeal. Mr. Justice Binnie, writing for the minority, put the issue in perspective when he stated:

> The fundamental issue in this case is the interpretation of everyday words used by Parliament in the context of a tax regime based on self-assessment. In 1997, the last year for which precise statistics are available, 20,453,540 tax returns were filed with Revenue Canada [the CCRA]. Most taxpayers are not (and likely have no desire to be) learned in the law. When confronted as here with the phrase "primarily in the manufacturing or processing of goods for sale or lease" under s. 127(9) of the *Income Tax Act*, S.C. 1970-71-72, c. 63 ("Act"), he or she is entitled, in my opinion, to the benefit of the plain meaning of an everyday word like "sale." The taxpayer was denied that benefit by the Minister in this case. The millions of taxpayers who are *not* lawyers cannot be expected to reach for *Benjamin's Sale of Goods* to research the difference between a contract for the sale of goods and a

60 Nitikman and Alty, supra footnote 47, at 2186.

61 See Arnold, supra footnote 47, at 6:32.

62 Supra footnote 5.

> contract for work and materials and to apply these distinctions in the assessment of their own income tax liability. I would therefore allow the appeal.[63]

Subsequently, he stated:

> In my view, ordinary words in the Act like "for sale" should also be interpreted in light of "the ordinary meaning of the word in everyday speech." Here, the supply of asphalt was specified, although the price was not allocated in the contract as between work and materials. The customer's objective was to obtain an asphalt driveway, and the services provided by the taxpayer were incidental to realization of that objective. The price was paid, and the customer became the owner of the asphalt in his driveway. The taxpayer and its customers were likely oblivious to the fact (relied on by the Minister) that, in the eye of the law, title to the steaming stretch of asphalt passed by accession.[64]

In contrast, Mr. Justice Major, writing for the majority, quoted the following from Chief Justice Issac's judgment in *Canada v. Hawboldt Hydraulics (Canada) Inc. (Trustee of)*:

> We are invited by the modern rule of statutory interpretation to give those words their ordinary meaning. But we are dealing with a commercial statute and in commerce the words have a meaning that is well understood. . . . Strayer, J. was right, in my respectful view, to say in *Crown Tire* at page 225 that:
>
> > . . . one must assume that Parliament in speaking of "goods for sale or lease" had reference to the general law of sale or lease to give greater precision to this phrase in particular cases.[65]

On the basis of the jurisprudence to date, there is no "correct" approach to statutory interpretation. In cases in which advisers are assessed pursuant to section 163.2, counsel will wish to put forth whatever interpretation best suits the client's interest. In this respect, we echo Arnold's comments:

> Probably the most appropriate way for tax practitioners to consider statutory interpretation is as rhetoric, a source of linguistic arguments with which to persuade others that a particular claim is right and just. From this perspective, there is no proper method of statutory interpretation; no particular method is better than any other method. Tax practitioners will simply choose whatever approach to, or principle of, statutory interpretation best serves their current needs. The objective is always to find some argument—any argument—that will appeal to a Revenue Canada [CCRA] or Finance official or to a judge. The various approaches to statutory interpretation and the principles or canons of statutory interpretation constitute a rich source of argument in this regard. There is an approach to statutory interpretation or a principle of statutory interpretation to justify any conclusion.

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63 Ibid., at 6474.

64 Ibid., at 6475.

65 [1995] 1 FC 830, at 847 (FCA), quoted in *Will-Kare*, supra footnote 5, at 6472.

> As the American legal realists demonstrated over 50 years ago, almost every principle of statutory interpretation is accompanied by its exact opposite.[66]

Even after the interpretative approach to the legislation is determined, meaning has to be given to individual words. Section 163.2 is a treasure trove of words that do not have well-defined technical meanings. (Examples include "culpable conduct," "false statement," "good faith," "assents," and "acquiesces.") The civil penalty provisions are therefore a veritable Eldorado for the person who is interested in statutory interpretation. Before the scope of the penalty provisions can be determined in any particular circumstance, the meaning of the words must be ascertained. For example, in *Nowegijick v. The Queen et al.*, the Supreme Court of Canada stated:

> The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to," "with reference to" or "in connection with." The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters.[67]

Again, our comments are designed not so much to tell the reader how to interpret the words, but to emphasize that the words do not always have to be given either a restrictive or an expansive meaning. For example, in most circumstances, the taxpayer will want words such as "reasonable" and "good faith" to be given a very expansive meaning, so that all actions are reasonable or performed in good faith. On the other hand, the taxpayer will want "reckless"[68] to be defined as connoting a very large deviation from normal activities, so that a minimum amount of care and due diligence will result in the conclusion that the taxpayer has not made a false statement in circumstances amounting to culpable conduct.

Courts have frequently stated that the administrative practices of the CCRA are entitled to be given "great weight,"[69] especially when the CCRA's published position is inconsistent with the position that it is taking in a particular case before a court. It is therefore instructive to bear in mind the CCRA's published position in interpreting the civil penalty provisions.

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66 Arnold, supra footnote 47, at 6:33.

67 83 DTC 5041, at 5045 (SCC).

68 The word "reckless" is used in the definition of culpable conduct, discussed below.

69 See, for example, *Nowegijick*, supra footnote 67, at 5044. See also *Will-Kare*, supra footnote 5, at 6478, in which Mr. Justice Binnie referred to the comments of Robert Weil of the CCRA at the Canadian Tax Foundation's 1973 annual conference (Robert D. Weil, "Manufacturing and Processing Tax Incentives," in *Report of Proceedings of the Twenty-Fifth Tax Conference*, 1973 Conference Report (Toronto: Canadian Tax Foundation, 1974), 124-35).

At the 2000 annual conference of the Canadian Tax Foundation, the CCRA enunciated the following eight principles that will guide its administration of section 163.2:

1) The legislation is intended to apply to those taxpayers and advisers who go beyond the bounds of the law in search of a result that underreports tax payable.

2) The legislation is intended to apply mainly to those arrangements and plans that are promoted and sold to the public and are not tax-effective.

3) The legislation is intended to address those advisers who counsel and assist others in making false statements in filing their returns.

4) The legislation is not intended to apply to day-to-day business activities and tax planning of a routine nature.

5) The legislation is not intended to apply to mistakes, oversights, and honest errors of judgment.

6) The legislation is not intended to apply to differences of interpretation where a bona fide uncertainty exists as to the application of the law.

7) The legislation is not intended to create additional audit/verification work for accountants and lawyers.

8) The legislation does not seek to impose a standard of conduct that is beyond what is expected by an accounting professional's body.[70]

Charging Provisions

Nature of Activity

As discussed above,[71] although subsections 163.2(2) and (4) overlap, the CCRA's view is that subsection 163.2(2) applies to planning and valuation activities and subsection 163.2(4) applies to reporting activities. A planning activity is defined[72] to include organizing or creating, or assisting in the organization or creation of, an arrangement, a plan, or a scheme. It also includes participating, directly or indirectly, in the selling of an interest in, or the promotion of, an arrangement, entity, plan, property, or scheme. The term "entity" is defined[73] to include an association, corporation, fund, joint venture, organization, partnership, syndicate, and trust. The terms "arrangement," "plan," and "scheme" are not defined, although

70 Presented by representatives of the CCRA who were members of the panel on civil penalties at the Canadian Tax Foundation's 2000 annual conference. See "Civil Penalties: Case Studies," in *Report of Proceedings of the Fifty-Second Tax Conference*, 2000 Conference Report (Toronto: Canadian Tax Foundation, forthcoming).

71 Under the heading "Overview of the Legislation."

72 Subsection 163.2(1).

73 Ibid.

arrangement is defined for purposes of the definition of excluded activity. The term "valuation activity" of a person is defined[74] very broadly to mean anything done by the person in determining the value of a property or a service. There is no definition of "reporting activity."

Level of Activity

Subsection 163.2(2) refers to a person who makes, furnishes, participates in the making of, or causes another person to make a false statement. Subsection 163.2(4) refers to a person who makes, participates in, assents to, or acquiesces in the making of a false statement.

The words "makes," "furnishes," and "causes" all require the professional to take an active role. Such activity is consistent with the underlying theory of the legislation that professionals who devise and promote schemes to reduce tax should be held responsible if the schemes that they devise are based on false statements. More difficult to interpret are the words "participates in," "assents to," or "acquiesces in" the making of a statement.

Black's Law Dictionary provides the following definitions:

> Acquiescence. A person's tacit or passive acceptance; implied consent to an act. . . . The result is that binding legal effect is given to silence and inaction. Acquiescence, as a principle of substantive law, is grounded in the concepts of good faith and equity.
>
> Assent. Agreement, approval, or permission.
>
> Participation. The act of taking part in something, such as partnership.[75]

In *Regina v. Rogo Forming Ltd. Corona and Maione*,[76] the definition of "acquiesce" was discussed in the context of section 242. His Honour Judge Vanek stated:

> The ordinary dictionary meaning of "acquiesce" is "to accept or consent quietly without protesting." The words of the statute have been said to include both active and passive participation in the offence committed by the company. I find no active participation. To my mind passive participation refers to the conduct of an individual who, having knowledge of the circumstances surrounding the default of the company and being in a position to influence the conduct of the company, stands by and allows the infraction to occur without taking any steps to prevent it.[77]

The word "participate" is defined[78] in the legislation to include the causing of a subordinate to act or to omit information, and to know of and not to make a

74 Ibid.

75 *Black's Law Dictionary*, 7th ed.

76 (1980), 56 CCC (2d) 31 (Ont. Prov. Ct.).

77 Ibid., at 41.

78 Subsection 163.2(1).

reasonable attempt to prevent the participation by a subordinate in an act or an omission of information.

A "subordinate" of a particular person is defined[79] to include any other person over whose activities the particular person has direction, supervision, or control. The definition uses a factual and not a legal test to determine whether one is a subordinate of another. The definition states that the other person need not be an employee of the particular person to be the subordinate of that person. The definition also provides that if the particular person is a member of a partnership, the other person is not a subordinate of that person solely because that person is a member of the partnership.

The Exchequer Court of Canada, in *Udell v. MNR*, in construing what is now subsection 163(2), stated:

> Each of the verbs in the language "participated in, assented to or acquiesced in" connotes an element of knowledge on the part of the principal and that there must be concurrence of the principal's will to the act or omission of his agent, or a tacit and silent concurrence therein.[80]

What is unclear is whether an adviser can be said to participate in, assent to, or acquiesce in the making of a false statement where the adviser did not create, actively promote, or encourage the taxpayer to make a false statement. Example 1 illustrates this issue.[81]

Example 1

Corporation XYZ is a multinational U.S. corporation established under the laws of Delaware with its head office in New York City. It has several wholly owned foreign subsidiaries, including one in Canada ("Canco"). Corporation XYZ provides knowhow to each of its subsidiaries and charges a royalty for the provision of such knowhow.

Corporation XYZ has had losses, for U.S. income tax purposes, for the last three years. In contrast, Canco has had taxable income, for purposes of the Act, for the last three years. Corporation XYZ wishes to divert income from Canco to itself. It accomplishes this by increasing substantially the royalty rate which it charges Canco. It also increases the royalty rate which it charges to all other foreign subsidiaries.

Canco's accountants, One in Five, are preparing its income tax return. Ms. X, who is the partner on the file, notices the revised royalty rate and is concerned that

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79 Ibid.

80 70 DTC 6019, at 6025 (Ex. Ct.).

81 This example, together with the other examples, illustrates a number of issues that arise in respect of section 163.2. However, for convenience of discussion, only the issue related to the meaning of "participates in, assents to or acquiesces in" is discussed at this stage of the article. We will return to the example later in the context of our discussion of other issues. (The alternative to this approach would have been to discuss examples once all the various issues were considered. We considered that the inclusion of an example with each issue would be more helpful to the reader.)

the royalty rate is not reasonable. She consults with a colleague, Mr. Y, who specializes in cross-border royalty rates. He indicates that he considers the royalty rate out of line with the royalty rates that other multinationals charge to their subsidiaries in similar circumstances and that he is also suspicious that the royalty rate is not reasonable in the circumstances.

The Vice-President, Taxation, of Canco, Mr. A, has a neighbour, Mr. B, who is a tax partner with a competing accounting firm, E.Z. Filing. Mr. A had discussed his corporation's planning techniques with Mr. B over wine one evening and Mr. B said that there should no problem with filing the tax return and it would be nice if he could get some business from Canco.

When Ms. X expresses her concerns to Mr. A, he tells her that he sees no issue and that he knows that E.Z. Filing would be happy to file the return on this basis. He also obliquely makes reference to the significant volume of business that Canco refers to One in Five and wonders whether One in Five is still interested in the business. As a result, Ms. X swallows hard and prepares the return based on the information Company XYZ has supplied to her.

The CCRA reassesses Canco on the basis that the royalty rate is unreasonable. At the same time that the CCRA reassesses Canco, it reassesses Ms. X and One in Five pursuant to the provisions of 163.2(4).

Ultimately, it is established that the maximum reasonable royalty is that set out in the agreement before the amendment and that the full amount of the increase is considered unreasonable.[82]

If a false statement has been made,[83] have Ms X and Mr. Y participated in, assented to, or acquiesced in the making of the false statement? Ms X and One in Five find themselves in the unenviable position of either having to assist the client in preparing the tax return in a manner with which they do not agree or facing the loss of substantial business. Do the partners of One in Five have any choice except to resign the engagement?[84]

A person can demonstrate that he has not participated in a false statement because he took reasonable steps to prevent a subordinate from participating in an act or an omission of information; therefore, can he not argue that he does not participate if he takes all possible steps to prevent the inappropriate filing?

In colloquial language, one does refer to an "unwilling participant." The words "participated in," "assented to," and "acquiesced" could be interpreted in a manner broad enough to lead to the conclusion that Ms X and Mr. Y participated in, assented to, or acquiesced in the making of a false statement. On the basis of the

82 This example was prepared for presentation by the panel for discussion on civil penalties at the Canadian Tax Foundation's 2000 annual conference, supra footnote 70.

83 This issue is discussed below when the meaning of "false statement" is considered.

84 In informal discussions with officials of the CCRA as part of the consultation process, they indicated that it is the CCRA's position that in such circumstances, the partners of One in Five have no alternative but to resign their engagement.

reasoning of Mr. Justice Vanek in *Rogo Forming Ltd.*, the court could conclude that Ms X and Mr. Y took all the steps they could to prevent the making of a false statement. In addition, if a court were to apply a purposive or teleological approach to the interpretation of the words in this factual situation, it could ascertain that the purpose of the legislation was to prevent tax advisers from counselling taxpayers to make false statements and that, in these circumstances, the tax advisers counselled no such thing. This would permit the court to give a restricted meaning to the words "participate in, assent to or acquiesce in" and hold that such words require that the accountants take positive action and not be passive actors in a filing. Such an interpretation would be consistent with the theme of the legislation, which requires either knowledge of the false statement or culpable conduct—that is, conduct more serious than mere negligence.[85]

Common Elements

Each of subsections 163.2(2) and (4) requires a determination of whether

- a statement has been made;
- the statement was a false statement;
- the person made it knowingly or in circumstances amounting to culpable conduct; and
- another person could use the false statement for purposes of the Act.

A Statement

Before there can be a false statement, there must be a statement. The concern has been expressed that in the context of the civil penalties legislation, "statement" may be interpreted to mean something less than a letter offering advice or counselling a course of action. *The Collins English Dictionary* defines the word "statement" to mean "the act of stating," "something that is stated, esp. a special prepared formal announcement or reply."[86] In Werner Heinrich's view,

> a "statement" is a term of widest possible import. It covers both oral and written communications or assertions. It includes notes to financial statements, opinions, certificates, tax returns, representations in a letter, agreements or anything in a document or electronic medium that purports to set out a fact or statement of law. It also applies to submission letters, notices of objection and responses to demands or requests for information.[87]

Consider the situation in which a taxpayer is selling the shares of his business. In order to take advantage of the holding in *The Queen v. Fortino et al.*[88]

85 See the discussion of culpable conduct, below.

86 *The Collins English Dictionary*, 2d ed.

87 Heinrich, supra footnote 2, at 4-5.

88 2000 DTC 6060 (FCA), aff'g. 97 DTC 55 (TCC).

that a non-competition payment is not subject to tax, the vendor agrees with the purchaser to enter into a non-competition agreement. It is common knowledge to all involved in the transaction that no real consulting work will be performed by the vendor. Is the contract prepared by the solicitor a statement? Is the solicitor who prepares the contract making a false statement?

Neither the dictionary definition of "statement" nor the jurisprudence is helpful in making this determination. However, the argument certainly remains open at this time that the preparation of a contract does not constitute the making or furnishing of a statement. It may well be that the ambit of the legislation may be narrowed by giving a much more restrictive meaning to "statement" than is commonly perceived and has been expressed in the various articles.

A False Statement

The term "false statement" is defined in subsection 163.2(1) to include a statement that is misleading because of an omission from the statement. False statement is not otherwise defined in the legislation.

A "false statement" is more than an inaccurate statement; it is a statement designed to mislead.[89] In a 1974 dissenting ruling, Mr. Justice Bastin stated that

> the use of the word "false" in section 10 of the *Ontario Limited Partnership Act* should be distinguished from the word inaccurate as the word "false" implies an intention to mislead or deceive.[90]

In *Hudson Bay Mining and Smelting Co. Limited v. The Queen*,[91] the taxpayer entered into a commercial transaction involving Manitoba Hydro. The taxpayer had attempted to separate the transaction into two parts. The first part consisted of a sale of assets, and the second part involved a "gift" to Manitoba Hydro in respect of which the taxpayer claimed a deduction pursuant to paragraph 110(1)(b) of the Act as it then read. In implementing the transaction, the taxpayer had acted on the advice of both an accounting firm and a law firm.

The CCRA challenged the transaction and also imposed a penalty upon the taxpayer. The taxpayer appealed both the reassessment and the penalty. Although the trial court upheld the minister's assessment, it rejected the imposition of penalties. With respect to the penalty, Mr. Justice Cullen, the trial judge, stated:

> [N]o attempt was made to hide it [the gift] from the Minister of National Revenue. The "gift" is found in the income tax return, and the tax benefit is claimed. There is no obligation to seek a tax ruling from the Department and failure to do so is hardly an attempt to hide the matter.

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89 See Heinrich, supra footnote 2, at 5.

90 *Kingsdale Securities Co. Ltd. v. MNR*, 74 DTC 6674, at 6691 (FCA), aff'g. 73 DTC 5194 (FCTD).

91 89 DTC 5515 (FCA), aff'g. 86 DTC 6244 (FCTD).

> Whether a gift or partial consideration, is really a legal characterization to be determined by the Court. As counsel for the plaintiff put it, "The Ministry [sic] would have [a] distinct advantage if he could levy a penalty everytime it [sic] disagrees with a taxpayer." Each case must be looked at carefully to determine if there is an omission or a false statement upon which to base a penalty. That is not the case here.
>
> Something more than mere disagreement must be determined: a false statement by a taxpayer, as an example, or gross negligence, or a finding by the tax department that an error was made deliberately. I do not believe there is the criminal onus of proving beyond a reasonable doubt, however. One cannot fault the plaintiff for putting the best possible light on the situation, including the suggested two deals, as long as the main feature is not hidden. I cannot find gross negligence here, or any attempt to bury information from the prying look of the Ministry [sic].[92]

The Court of Appeal upheld the judgment of the trial judge.

As part of the consultation process leading to the recent publication of an information circular by the CCRA,[93] the suggestion was made to the CCRA that it adopt as a "bright-line" test that as long as there is complete disclosure in the tax return, there is no false statement. The CCRA was not receptive to this suggestion. As discussed above,[94] the very reason for the implementation of the subsection 163.2(4) penalty is to deter tax preparers from counselling taxpayers to claim expenses to which they are not entitled. To take the position that a statement is not a false statement as long as there is complete disclosure in the tax return might well read subsection 163.2(4) out of the Act. The CCRA does get some support from the recent cases of *Vallerand v. The Queen*,[95] *[S] Lamarre v. The Queen*,[96] and *[M] Lamarre v. The Queen*,[97] in which His Honour Judge Tardiff imposed subsection 163(2) penalties, notwithstanding that there had been disclosure in the tax returns of a tax-avoidance scheme. While the judge's reasoning could have been more explicit, his holding appears to be based on the lack of a bona fide belief by the taxpayer that he or she was entitled to the deduction.

Basing the determination of whether a statement is false on the bona fide belief of the taxpayer will be a very difficult test to apply. Nevertheless, it is the test applied in *Hudson Bay* and the test that is consistent with the legislative policy objectives of the Department of Finance. The application of this test will be particularly difficult where what is at issue is the reasonableness of a deduction or

92 Ibid., at 6250-51 (FCTD).

93 See supra footnote 4.

94 Under the heading "Background—Intent of the Legislation."

95 2000 DTC 3633(S) (TCC).

96 2000 DTC 3633(S) (TCC).

97 2000 DTC 3632(S) (TCC).

an interpretation of the Act. For example, it is common knowledge that few tax professionals would have anticipated the success of the taxpayers in the cases of *Fortino*[98] and *Duha Printers (Western) Ltd. v. The Queen*.[99]

Is there a false statement in example 1 set out above? We know that the new royalty rate is ultimately determined to be unreasonable. However, Canco did disclose the increase in the royalty rate and filed its tax returns accordingly. More facts would have to be known as to whether Canco was taking a position that, while aggressive, might have been defensible or whether it was taking a position that could not be supported under any circumstances.[100] Surely, as long as there is a bona fide position to be taken, however unlikely it is that the position will be upheld in court, Canco is entitled to file its tax return accordingly, without the risk that it will be subject to penalties pursuant to subsection 163(2) and its advisers will be subject to penalties pursuant to section 163.2. After all, this is the only way that Canco can put its position before the CCRA and, ultimately, a court.[101]

Our self-assessment system works on the basis that a taxpayer is entitled to put forward to the CCRA any position that he or she chooses, provided that the taxpayer has a bona fide view that the position has merit and he or she does not try to mislead the CCRA. Therefore, an assertion by the taxpayer that he or she is entitled to a deduction, accompanied by sufficient information to allow the CCRA to evaluate the taxpayer's position, should not amount to a false statement.

It may be that the disclosure made by the taxpayer in the return will be relevant to a court in determining whether the taxpayer has taken a bona fide position that, in the taxpayer's view, has merit or has simply tried to "slip one through" the system. In circumstances in which the taxpayer wishes to take an aggressive position, the taxpayer should make sufficient disclosure to negate an assertion by the CCRA that there is a false statement.[102] Example 2 illustrates this issue.

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98 Supra footnote 88.

99 98 DTC 6334 (SCC).

100 In a real-life situation, consideration would have to be given to any steps that Canco had taken to satisfy the provisions of section 247. It might well be that if Canco prepared contemporaneous documentation supporting the new royalty rate, the accountants could say that although they were suspicious, they were entitled to rely on the section 247 material. If the section 247 material were totally lacking in accuracy, it might well be that those materials would be considered the false statements, rather than the statements referred to in the return. In addition, consideration would have to be given to the application of subsections 163.2(10) and (11), which are discussed more fully below.

101 Other than filing a tax return on the basis that the royalty was unreasonable and then objecting to any assessment issued by the minister. This would be a rather cumbersome way of putting the issue before the CCRA and the courts.

102 See, for example, Stanley E. Edwards, "Issues in Tax Administration: A Round Table Discussion," in *Income Tax Enforcement, Compliance, and Administration*, 1982 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1983), 242-50, at 243, where

Example 2

X Co is a small business that annually generates less than $200,000 of income. Shortly after the year-end, one external CA is finalizing statements; he notices that taxable income is $250,000. He books an entry for a bonus payable of $50,000 and advises the taxpayer to pay the bonus after the end of the year. The accountant prepares the tax returns on that basis. The obvious issue here is that a valid liability probably did not exist at the end of the year. Will the civil penalties apply to this accountant?[103]

Disclosure could consist of a note to the financial statements that although a bonus was paid, there was no written agreement in existence at the end of the year. Alternatively, a covering letter could explicitly set out the facts.

A False Statement Made Knowingly

Whether a person knows something is a question of fact. In most cases, whether the professional knows that a statement is false will be determined on the evidence on the basis of the balance of probabilities test applicable to civil actions. Example 1 illustrates this principle. The CCRA's stated position with respect to this example is that the CCRA might not have to establish that Ms X and Mr. Y engaged in culpable conduct because each of them knew that there was a false statement.[104] Is the CCRA's position correct? What did Ms X and Mr. Y know?

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he states the following with respect to the general principles for completing tax returns: "When a relevant fact is a matter of opinion (such as the value of an asset at a particular time), the taxpayer should use his own judgment in determining that fact. He is entitled to resolve doubts in his own favour, provided that it is clear in his return that the point is a matter of opinion and his opinion has some basis and is honestly held."

103 This example was prepared for presentation by the panel for discussion on civil penalties at the Canadian Tax Foundation's 2000 annual conference, supra footnote 70. The CCRA's position was that the answer depended upon the facts. Where there had been a history of paying bonuses, there might well be an agreement to pay sufficient bonuses to bring the taxable income down to $200,000. The CCRA indicated that if this were the first year of operation, there may well be a false statement.

104 The speaker notes prepared by the CCRA in response to this example at the conference state in part:

> This case involves an advisor who has knowledge of inflated royalties used by her corporate client. She nonetheless files the client's tax return based on this information, as the client alluded to the fact that its significant business could be taken to a competitor who is willing to file on that basis.
>
> Analysis
>
> We find the following facts to be relevant in determining whether the advisor could be liable to the civil penalty:
>
> the advisor had concerns that there existed a false statement, which she then confirmed with a specialist. Accordingly, in this particular case, it may not even be necessary to refer to culpable conduct as the advisor arguably "knows" the statement is false. This is because subsections 163.2(2) and (4) of Act refer, in part, to "the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct."

Each saw the royalty rate increase. Each was suspicious that the royalty rate was unreasonable, on the basis of their knowledge of the industry in which corporation XYZ carries on business. However, neither *knew* that the royalty rate was unreasonable. They were not privy to any discussions about the increase in the royalty rate, nor were they privy to any studies indicating how the royalty rate was determined and whether it was in excess of whatever parameters were used to determine a reasonable royalty rate.[105]

The one situation in which the state of knowledge arises as a legal issue occurs with a partnership. As noted previously, a partnership is a person for purposes of section 163.2.[106] Where a partner knows that a statement is false, the partnership is deemed to know that the statement is false.

Partners are jointly and severally liable for each other's actions. This principle can be found in section 13 of the Partnerships Act (Ontario)[107] and is rooted in the principal/agent relationship. Under the law of agency, a principal is bound by the actions of his or her agent as long as the agent is acting in the scope of the agent's authority.

In addition, section 11 of the Partnerships Act (Ontario) provides:

> Where by any wrongful act or omission of a partner acting in the ordinary course of business of the firm, or with the authority of the co-partners, loss or injury is caused to a person not being a partner of the firm, or any penalty is incurred the firm is liable therefore to the same extent as the partner so acting or omitting to act.

Identical provisions are contained in the other common law partnership statutes.

In *Thompson v. John Patterson Construction Co. Ltd.*,[108] the Ontario Court of Appeal considered the liability of partners and the partnership for the actions of one partner. In that case, the loss occurred solely as a consequence of the conduct of one partner. The court quoted with approval the following general principle from *Lindley on Partnership*:

> Even if a loss sustained by a firm is imputable to the conduct of one partner more than that of another, still, if the former acted *bona fide* with a view to the benefit of the firm, and without culpable negligence, the loss must be borne equally by all.[109]

One situation that may arise in the partnership context occurs where two or more partners have knowledge of different facts. Can the knowledge of those

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105 If the CCRA is not correct that Ms X and Mr. Y knew that there was a false statement, the issue becomes whether they would reasonably be expected to know that there was a false statement but for circumstances amounting to culpable conduct. This issue is discussed below in the text accompanying footnote 129.

106 Subsection 163.2(1).

107 RSO 1990, c. P.5, as amended, which is typical of partnership legislation in the common law provinces.

108 [1942] OWN 678 (CA).

109 Ibid., at 679, quoting *Lindley on Partnership*, 10th ed. (London: Sweet & Maxwell, 1935), 459.

facts be put together to result in the knowledge of a false statement by the partnership? Example 3 illustrates this issue.

Example 3

Within one office of a firm, corporate tax returns and year-end statements are prepared. During the course of that preparation, it came to the attention of the preparer that there were loans outstanding during the year to an owner/manager shareholder. The loans were all cleared up by the end of the year either through the payment of dividends or bonuses. However, the person dealing with the corporate situation was aware that the existence of these loans during that part of the year gave rise to a section 80.4 benefit. This, however, had nothing to do with the corporate matter and had no effect on the preparation of the corporate returns nor on the year-end audit. The taxpayer client prepared its own T4 slips and did not include any section 80.4 benefit in the T4 slip of the owner/manager. Another individual within the firm and at a different office actually prepared the tax return for the owner/manager. He accepted that the T4 slip from the owner/manager together with his other information in a statement was everything needed to do the return. No individual had knowledge that the section 80.4 benefit existed and was not included in the individual's return. However, did the firm *per se* know that this was the case because a firm or partnership is deemed to have the knowledge that any of its partners had?[110]

The Supreme Court of Canada decision in *Martin v. MacDonald Estate (Gray)*[111] addressed the appropriate standard to be applied in determining whether solicitors who join another law firm should be disqualified from continuing to act in litigation by reason of a conflict of interest. Mr. Justice Sopinka refused to adopt the concept of imputed knowledge but stated that

> there is, however, a strong inference that lawyers who work together share confidences . . . [and a court should draw this inference] unless satisfied on the basis of clear and convincing evidence, that all reasonable measures have been taken to ensure that no disclosure will occur by the "tainted" lawyer to the member or members of the firm who are engaged against the former client.[112]

To date, there is no jurisprudence that has adopted the position that one can aggregate the knowledge of each of the partners or employees of a professional partnership and conclude that the partnership had such knowledge or that it was guilty of culpable conduct where no partner or employee demonstrated culpable conduct.

The issue in example 3 is whether the person preparing the return has demonstrated culpable conduct by not contacting the person preparing the corporate return to ascertain whether there is any information of which he should be aware in preparing the return.

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110 From the unpublished transcript of Ralph Neville's comments prepared for presentation at the Canadian Tax Foundation's 1999 annual conference, supra footnote 14.

111 [1991] 1 WWR 705 (SCC).

112 Ibid., at 726.

Culpable Conduct

If a tax professional did not know that a statement was a false statement, he or she will be subject to penalties pursuant to section 163.2 only if he or she would have known that the statement was a false statement but for circumstances amounting to culpable conduct.

The term "culpable conduct" is defined[113] to mean conduct, whether an act or a failure to act, that

- is tantamount to intentional conduct;
- shows an indifference as to whether the Act is complied with; or
- shows a wilful, reckless, or wanton disregard of the law.

The law recognizes five levels of intent:[114]

1) purpose,
2) knowledge,
3) recklessness,
4) negligence, and
5) strict liability.

The following extract from an American textbook illustrates these different levels of intent:

> Imagine for instance a parent who has come into a room and found her child has just smashed a valuable vase:
>
> Parent: You smashed that vase deliberately! (This is her most serious charge—that the child's conscious object was to break the valuable vase; in other words, that the child had "purpose").
>
> Child: No, that is not what I wanted to do at all. I didn't want to break the vase.
>
> Parent (presumably trained as a lawyer): Even if that is true, you knew that when you let the vase hit the ground it would break, even though you might only have wanted to make a loud noise.
>
> Child: No, I did not know that it would break at all, especially since my friend dropped a vase at his house and it didn't break, but I realize now that his is made of unbreakable plastic.
>
> Parent: Even so, you knew that the vase *might* break. You recognized the risk when you dropped it or threw it to the ground, and despite this recognition you acted anyway. You took the chance. In other words, you were reckless.

113 Subsection 163.2(1).

114 Chapter 8 of M.L. Friedland and Kent Roach, *Criminal Law and Procedure: Cases and Materials*, 8th ed. (Toronto: Emond Montgomery, 1997); and *The Queen v. Sault Ste. Marie*, [1978] 2 SCR 1299.

> Child: No, I didn't. It never occurred to me that the vase might break. I was sure it wouldn't.
>
> Parent: In that case, you *should have known* that the vase would break. You are six years old and we expect a six-year-old to have knowledge that such a result would occur. In other words, you were negligent.
>
> Child: From now on you can expect me to have this knowledge, but it is too much to ask of a six-year-old, who has had no previous experience dropping vases, to realize that they might break.
>
> Parent (adopting a kind of mental state that the quoted passage from the Model Penal Code (American Law Institute, Model Penal Code and Commentaries, 1985, section 2.02(2)) did not mention, but that the trial judge instructed the jury to apply in *Regina v. Faulkner* (Court of Crown cases, Reserved, Ireland, 13 Cox CC 550 (1877)): You should not have been playing with the vase to begin with. You should have been in your room resting at the time.
>
> Child: In that case, I should be punished only for not resting in my room or for playing with the vase, but not for the more serious offence of breaking it.
>
> Parent (impressed with her child's argument for his lack of a culpable state of mind with respect to the vase, but nonetheless eager to punish): It does not matter, I will punish you for breaking the vase because you are *strictly liable*.
>
> Child: This is fundamentally unjust.[115]

On the basis of the foregoing hierarchy of intent, a tax adviser is not strictly liable for a false statement and must demonstrate something more than mere negligence in order to be considered to have engaged in culpable conduct.

The definition of "culpable conduct" uses the following words taken from *Venne v. The Queen* in describing "gross negligence" for the purposes of subsection 163(2):

> "Gross 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.[116]

In *The City of Kingston v. Drennan*,[117] the Supreme Court of Canada addressed the issue of when an act of a municipal corporation constitutes "gross negligence" under the Municipal Act (Ontario). In affirming the decision of the Court of Appeal and finding that the City of Kingston had committed "gross negligence" and was liable for an accident, Mr. Justice Sedgewick, for the court, stated:

> I am not bold enough to enter upon a detailed investigation as to the difference between gross and other kinds of negligence. That question has been discussed by

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115 John Kaplan, Robert Weisburg, and Guyora Binder, *Criminal Law: Cases and Materials*, 3d ed. (Frederick, MD: Aspen Law & Business, 1996), 228.

116 *Venne*, supra footnote 30, at 6256.

117 (1897), 27 SCR 46.

> civilians and text-book writers to such an extent that judges have been found to say that there are no degrees of negligence. However this may be we must, I suppose, give some meaning to this expression of the legislative will and the meaning I give to it is "very great negligence."[118]

The courts, however, have drawn a distinction between gross negligence and wilful or wanton misconduct. In *McCulloch v. Murray*, Mr. Justice Duff for the Supreme Court of Canada addressed the issue of whether a motor vehicle accident was caused by "the gross negligence or wilful and wanton misconduct" of the appellant by stating,

> I am, myself, unable to agree with the view that you may not have a case in which the jury could properly find the defendant guilty of gross negligence while refusing to find him guilty of wilful or wanton misconduct. All these phrases, gross negligence, wilful misconduct, wanton misconduct, imply conduct in which, if there is not conscious wrongdoing, there is a very marked departure from the standards by which responsible and competent people in charge of motor cars habitually govern themselves. Subject to that, I think it is entirely a question of fact for the jury whether conduct falls within the category of gross negligence, or wilful misconduct, or wanton misconduct. *These words, after all, are very plain English words, not difficult of application by a jury whose minds are not confused by too much verbal analysis* [emphasis added].[119]

One of the most often-quoted decisions that has attempted to define gross negligence is that of the Ontario Court of Appeal in *Harper v. The Town of Prescott*, where Mr. Justice McTague, for the court, described it as "very great negligence" and as a breach of duty that "approaches the wilful, the reckless, the wanton."[120]

The meaning of "gross negligence," "wilful misconduct," "wanton misconduct," or "recklessness" cannot be determined without first considering what is meant by the term "negligence." A distinction must be drawn between "negligence" in the sense of conduct that falls below what is socially acceptable and negligence as a cause of action. The author of *Canadian Tort Law* suggests the following formula for determining negligence as a cause of action:

> A cause of action for negligence arises if the following elements are present: (1) the claimant must suffer some damage; (2) the damage suffered must be caused by the conduct of the defendant; (3) the defendant's conduct must be negligent, that is, in breach of the standard of care set by the law; (4) there must be a duty recognized by the law to avoid this damage; (5) the conduct of the defendant must be a proximate cause of the loss or, stated in another way, the damage should not be too remote a result of the defendant's conduct; (6) the conduct of the plaintiff

118 Ibid., at 60.

119 [1942] SCR 141, at 145. Obviously, the problem is that there are too many tax professionals looking at the issue. Presumably, if there were fewer professionals looking at the issue, it would go away.

120 [1939] OWN 492, at 492 (CA).

> should not be such as to bar recovery, that is the plaintiff must not be guilty of contributory negligence and must not voluntarily assume the risk.[121]

Historically, the Act has used the term "gross negligence" as meaning very great negligence where the term "negligence" has the meaning in item (3) above, a breach of the standard of care set by law. The question then becomes, what is the standard of care set for professionals in section 163.2?[122] Cases involving solicitors' negligence give us some indication of the minimum standard that tax advisers are likely to be held to when the civil penalty provisions are put before the courts.

In *Central Trust Co. v. Rafuse*,[123] Mr. Justice Le Dain for the court found that the respondent solicitors had not met the standard of a "reasonably competent solicitor" by failing to inform themselves of the impact of section 96(5) of the Companies Act on a corporation's capacity to give security. He quoted with approval the following passage from *Charlesworth & Percy on Negligence*:

> Although a solicitor is not bound to know the contents of every statute of the realm, there are some statutes, about which it is his duty to know.[124]

Moreover, there is judicial authority to the effect that specialists will be held to a higher standard than the "ordinary prudent solicitor." In *Elcano Accept. Ltd. et al. v. Richmond, Richmond, Stambler & Mills*, the Ontario Supreme Court stated:

> I am accordingly inclined to opt for the approach that recognizes a distinction between the specialist and the generalist practitioners when defining the standard of care. The fictional reasonable man against whom the defendant generalist solicitor will be measured must continue to avail. And it seems to me that whether or not the solicitor's duty is founded in a contract to which he as a specialist is party, or in tort by virtue of a special relationship in which he has held himself out to possess specialist skills and knowledge upon which his client will likely rely, a reasonably competent specialist standard can be applied to determine liability.[125]

On the basis of the reasoning in *Elcano*, whether a tax adviser has engaged in culpable conduct will depend upon his or her sophistication or purported sophistication.[126]

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121 Allen M. Linden, *Canadian Tort Law*, 6th ed. (Markham, Ont.: Butterworths, 1997), 99.

122 For a discussion on the liability of tax advisers, see D.J. Sherbaniuk, "The Liabilities of Tax Advisers," in *Report of Proceedings of the Thirtieth Tax Conference*, 1978 Conference Report (Toronto: Canadian Tax Foundation, 1980), 96-131, and David W. Smith, "Dealing with Tax Risk in an Opinion," in *Report of Proceedings of the Forty-Sixth Tax Conference*, 1994 Conference Report (Toronto: Canadian Tax Foundation, 1995), 38:1-23.

123 [1986] 2 SCR 147.

124 Ibid., at 208, quoting *Charlesworth & Percy on Negligence*, 7th ed. (London: Sweet & Maxwell, 1983), 577-78.

125 (1985), 31 CCLT 201, at 213 (Ont. SC), rev'd. on a procedural point 55 OR (2d) 56 (CA).

126 If a firm of lawyers or accountants hold themselves out as leaders in, say, international tax planning, they can hardly complain if their competence is measured against that standard.

The definition of "culpable conduct" in subsection 163.2(1) has been crafted so that the various components of Mr. Justice Strayer's definition of "gross negligence" have become stand-alone criteria in determining whether or not a person has demonstrated "culpable conduct." The word that has troubled practitioners most has been "indifference." The courts in *Venne* and *Malleck v. The Queen*[127] defined indifference as equivalent to wanton misconduct or recklessness. Concern has been expressed that a professional has to meet a higher standard of care to show that he is not indifferent than that which he would have to meet to show that he was not reckless or wanton. Unfortunately, there is very little jurisprudence other than *Venne* and *Malleck* that defines "indifference." In *Shortt v. Rush and Br. Amer. Oil Co., Ltd.*, Mr. Justice MacKenzie writing for the Saskatchewan Court of Appeal quoted with approval the following passage from the trial judge's instructions to the jury on the meaning of "indifference sufficient to constitute gross negligence":

> [This phrase should be understood to mean] such indifference as would lead you to conclude that he [the defendant] did not care one way or the other and was taking a chance if I may use the words; he was taking a chance as to the result; did not care about the consequences, and he realized his position; that he did not care, and anyway he was going to take a chance. It does not mean that he did not think. It means that in the circumstances he was careless of the result and "took a chance."[128]

In example 1 above, if it cannot be said that Ms X and Mr. Y knew that there was a false statement, but a court concludes that there was a false statement, the question remains whether Ms X and Mr. Y participated in making that false statement in circumstances amounting to culpable conduct.[129] They have not exhibited conduct that is tantamount to intentional conduct. They have certainly not shown indifference in that they have suggested to the client as strongly as possible that the client not file the return this way. Furthermore, it cannot be said that they have acted recklessly or with wilful or wanton disregard for the law.

The CCRA has stated[130] that an adviser does not have to incur any additional expenses or take any extra measures in order to satisfy the obligations that he or she has under the civil penalty provisions. While Ms X and Mr. Y may suspect that the statement is a false statement, do they have an obligation to do more? On the basis of the CCRA's position, the answer is no. They would certainly not have to obtain their own valuations.[131]

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127 Supra footnote 30.

128 [1937] 2 WWR 191, at 195 (Sask. CA).

129 It is assumed that the court finds that they either participated in, assented to, or acquiesced in the making of the false statement.

130 Supra footnote 70.

131 It has been suggested to us that as a practical matter, many advisers have a copy of a letter to the client or a note in their files indicating that they raised their concerns with their client. First of all, in the circumstances of this particular situation, if Ms X or Mr. Y had written to

Example 4 illustrates the issue of culpable conduct in another factual situation.

Example 4

Mr. X is a successful entrepreneur who resides in Saskatchewan. He is in his late 60s. His wife is still alive. He has two children in their early 40s and four grandchildren. One of the big banks was putting on a presentation about estate planning, and Mr. X realized that he had done little in the way to reduce the taxes which will arise on his death. He had made a will a number of years ago, but this was long before he had realized any material success.

Mr. X's major asset is all of the issued and outstanding shares of a manufacturing corporation ("Manuco"), which manufactures products used in farming operations. Mr. X has traditionally obtained legal advice from Mr. Y, a sole practitioner in his community. Mr. X approaches Mr. Y to obtain estate planning advice. Mr. Y is of the view that the problem is beyond his sphere of competence and refers him to Mr. B (for Big) in Toronto, one of Canada's leading estate planners. Mr. Y does this for two reasons. He wants to make sure that Mr. X gets the best advice possible. He is also concerned that if he refers Mr. X to a local lawyer who does have estate planning competence, that lawyer might take Mr. X's business from him.

Mr. X consults Mr. B and tells Mr. B that he, Mr. X, bought Manuco in 1972 and paid $2 million for it. He presents a letter from his auditor, Mr. Z, in which the auditor casually states that he thinks the value of the shares in Manuco are worth $15 million.

Mr. B suggests an estate freeze pursuant to which Mr. X will transfer his shares to a new holding corporation ("Holdco") in exchange for voting preferred shares with a redemption amount of $15 million. Under the plan, Mr. X's two children now subscribe for the common shares of Holdco for a nominal amount. Mr. B suggests that Mr. X obtain a more detailed valuation, but Mr. X, conscious of fees, insists that the advice that he has already received from his accountant is satisfactory.

Mr. B prepares the documentation to effect the estate plan. As a very cautious solicitor, he ensures that one his firm's associates prepares and files the section 85 election form, Form 2057, immediately after the execution of the documents. Form 2057 indicates an adjusted cost base ("ACB") of $2,000,000 and an elected amount of $2,000,000.

The CCRA subsequently reviews the transaction and discovers that while Mr. X did pay $2,000,000 to acquire Manuco, only $100,000 was for the purchase of the shares. The balance of $1,900,000 was used to acquire a loan made by the

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the client pointing out his or her objections to the plan, such an action might well have been the straw that broke the camel's back and have caused Canco to terminate the relationship. Moreover, it will not be very helpful to One in Five to have correspondence in existence that could be used to support a reassessment of Canco for making a false statement pursuant to subsection 163(2). Moreover, while such a note may go to the issue discussed above (in the text accompanying footnote 81) of whether Ms X and Mr. Y participated in the making of the false statement, it does not go to the issue of whether they should have known, but for their culpable conduct, that there was a false statement.

> vendor-shareholder to Manuco. The loan had long since been repaid to Mr. X. Consequently, Mr. X's ACB of the shares was only $100,000.
>
> The CCRA reassesses on the basis that Mr. X's ACB for the shares was only $100,000. It also challenges the value of the shares of Manuco and reassesses pursuant to paragraph 85(1)(e.2) on the basis that the shares had a value of $25 million. At the same time, the CCRA reassesses Mr. B pursuant to subsection 163.2(2).
>
> Mr. X objects to the reassessment on the basis that the shares of Manuco had a value of only $15,000,000; he accepts that his ACB of the shares was $100,000. Mr. X retains Mr. Z to prepare a formal valuation. At trial, Mr. Z produces a valuation report stating that the value of the shares at the time of the transfer was $15,000,000. The CCRA produces its own valuator, who uses different forecasts and assumptions, and reports that the value of the shares was in fact $25,000,000. The trial judge comes to the decision that the shares had a value, at the time of transfer, of $18,000,000.[132]

The first issue is whether either the transfer documents pursuant to which Mr. X received voting preferred shares with a redemption amount of $15 million or the elected amount in form T2057 is a statement. If one assumes that each constitutes a statement, the second issue is whether either is a false statement.

It is easier to suggest that the elected amount in form T2057 constitutes a false statement because of the wide variation between the actual ACB of $100,000 and the reported ACB of $2 million. It is more difficult to conclude that the transfer documents and the related fair market value statement on form T2057

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132 This example was prepared for presentation by the panel for discussion on civil penalties at the Canadian Tax Foundation's 2000 annual conference, supra footnote 70. The speaker notes prepared by the CCRA in response to this example at the conference state in part:

> Mr. B is involved in a planning activity as the term is defined in subsection 163.2 of the Act; however, he is not involved in an excluded activity but conventional tax planning; hence he can rely in good faith on information provided by Mr. X or by someone on behalf of Mr. X.
>
> The ACB of the shares of Manuco did not seem to be implausible. Therefore, it could be argued that Mr. B did not have to make further inquiries into this matter.
>
> Mr. B also is entitled to rely in good faith on the valuation issue. If the value of shares did not appear to be implausible to Mr. B, his conduct is not culpable conduct.
>
> With respect to Mr. Z, it would be appropriate to review the facts and assumptions used by Mr. Z in preparing his valuation to determine whether the valuation is reasonable and not based on assumptions that are unreasonable or misleading.
>
> A penalty on Mr. Z would be considered if the valuation was based on false or misleading information and/or assumptions such that his conduct was determined to be culpable conduct. In this case it appears that Mr. Z's actions would not lead to such a finding.
>
> As a general observation, we would expect that in real life greater attention is paid to amounts and values that are relevant for a purpose under the Act.

constitute a false statement. In absolute terms, the value differs from the court's determination of fair market value by $3 million, but in percentage terms, it varies by only 16⅔ percent.

If either statement is a false statement, has Mr. B participated in making it knowingly or in circumstances amounting to culpable conduct? Mr. B did not know that the value of Manuco was not correct or that Mr. X's ACB was not $2 million. The issue then becomes whether, but for culpable conduct, he would have known that either statement was a false statement. On the facts, it cannot be said that Mr. B's conduct is tantamount to intentional conduct. Mr. X is not attempting to obtain any advantage not specifically provided for by the Act and Mr. B is not advising him in any manner so as to obtain an improper benefit.

In addition, it cannot be said that Mr. B was indifferent in complying with the provisions of the Act. On the contrary, he attempted to ensure that the appropriate T2057 form was filed as part of the closing. Finally, it cannot be said that Mr. B was acting in a wanton or reckless manner. Mr. B accepted the value put on Manuco by Mr. Z. He knew that Mr. Z had not done a complete valuation; however, Mr. B, who is a lawyer and not an accountant, was specifically instructed not to obtain a more detailed valuation. What more, if anything, is Mr. B required to do in this situation in order to establish that he did not participate in making a statement in circumstances amounting to culpable conduct?[133]

A False Statement That Could Be Used

Presumably, the word "could" was used so that the CCRA would not have to establish a link between the false statement and the claiming of the deduction by the taxpayer. Heinrich states that penalties can apply even if a false statement is never used for purposes of the Act.[134] It is only necessary that the statement "could be used."

The word "could" is not defined in any of the legal dictionaries. In *The Canadian Oxford Dictionary*, it is defined simply as "to express probability."[135]

In *R v. Dattenberger*,[136] the issue before the court was the adequacy of the notice given to an accused with respect to the use of a certificate of analysis of a breathalyzer test. A police officer told the accused that "the Certificate of Analysis could be used as evidence in a trial against him."[137] Mr. Justice Lynch-Staunton noted that "could be" may include "will be" but is not limited to that

133 The good faith defence may apply in this example. This principle is discussed below.

134 Heinrich, supra footnote 2, at 11.

135 *The Canadian Oxford Dictionary* (Don Mills, Ont.: Oxford University Press, 1998).

136 (1982), 20 MVR 300 (Alta. Prov. Ct.).

137 Ibid., at 302.

interpretation, and cited[138] the following definition found in "*The Senior Dictionary*": "Could, the past of can, and might, originally the past of may, are now used chiefly to convey a shade of doubt or a slight degree of possibility." This definition sets a very low standard of probability.

Nichols offers the example of a plan that is not used but put in a file, and suggests that "could" extends to making the professional liable for the preparation of the plan.[139] We suggest that in such circumstances, there is no person who "could" use the plan. The word "could" requires that there be one or more persons who are capable of using the plan, and capability necessarily implies access to the plan. Nichols's example assumes that there is a person who becomes aware of the plan and becomes the identifiable person; on the facts, no such person exists. However, our objection on this point may amount to quibbling. Although tax commentators frequently portray the CCRA as dogged in its determination to challenge taxpayers unfairly, it will certainly be in very rare circumstances that CCRA auditors will look for unused plans left in files. In all likelihood, it will only be where a tax return is filed in which income is excluded or an unwarranted deduction is claimed that there will be an assessment pursuant to section 163.2.

Good Faith

Subsection 163.2(6) provides that an adviser who acts on behalf of the other person referred to in subsections 163.2(2) and (4) is not considered to have acted in circumstances amounting to culpable conduct in respect of the false statement solely because the adviser relied, in good faith, on information provided to the adviser by or on behalf of the other person or because, as a result of such reliance, the adviser failed to verify, investigate, or correct the information.

For the good faith defence to apply, the adviser must have relied on information provided either by the other person or on behalf of the other person. Discussed below is the issue of whether the good faith defence is significant. On the assumption that a person would otherwise have engaged in culpable conduct but for obtaining some particular piece of information, the adviser must demonstrate that the information was acquired from the other person or from someone acting for or on behalf of the other person in order for the good faith defence to apply. An adviser cannot invoke the good faith defence in respect of information derived from an independent source. However, evidence that the adviser had obtained such information might establish that the adviser had not engaged in culpable conduct.

Few phrases are more nebulous than the term "good faith." Legal dictionaries provide a variety of definitions. For example, *The Dictionary of Canadian Law* defines "good faith" in part as follows:

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138 Ibid.

139 Nichols, supra footnote 2, at 64-66.

> 1. Honesty in fact in the conduct of the transaction concerned. 2. A thing is deemed to be done in good faith within the meaning of an act when it is in fact done honestly, whether it is done negligently or not.[140]

Jowitt's Dictionary of English Law defines "good faith" in part as follows:

> A thing is deemed to be done in good faith if it is done honestly, whether or not it is done negligently.[141]

The most recent edition of *Black's Law Dictionary* defines "good faith" in part as

> [a] state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, . . . (4) absence of intent to defraud or to seek unconscionable advantage.[142]

An earlier edition of *Black's Law Dictionary* provided another element that does not appear in the current editions of the legal dictionaries:

> Honesty of intention, and freedom from knowledge of circumstances which ought to put the holder upon inquiry.[143]

Section 135(4) of the Ontario Business Corporations Act[144] is similar to subsection 163.2(6) and states:

> A director is not liable under section 130 or 134 if the director relies in good faith upon, . . .
>
> (b) a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by such person.

Section 135(4)(b) of the OBCA was discussed in *Blair v. Consolidated Enfield*.[145] In that case, the appellant, in his role as president and director of Consolidated Enfield, had relied on advice provided by the corporation's solicitors and wished to rely on section 135(4)(b) as a defence to a claim made against him. Mr. Justice Iacobucci writing for the Supreme Court of Canada found that Mr. Blair had acted prudently and in good faith when he relied on the solicitors' advice. Mr. Justice Iacobucci imported the factor noted above in the earlier *Black's Law Dictionary* definition of "good faith": the person relying in good faith on the information supplied by another must not have any reason for suspecting either the honesty or the competence of that other person.[146]

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140 Daphne A. Dukelow and Betsy Nuse, *The Dictionary of Canadian Law* (Scarborough, Ont.: Carswell, 1991).

141 John Burke, ed., *Jowitt's Dictionary of English Law*, 2d ed. (London: Sweet & Maxwell, 1977).

142 Supra footnote 75.

143 *Black's Law Dictionary*, 5th ed., as cited in *Springridge Farms (Trustee of) v. Spence* (1991), 7 CBR (3d) 228, at 235 (Sask. QB).

144 RSO 1990, c. B.16, as amended (herein referred to as "the OBCA").

145 [1995] 4 SCR 5.

146 Ibid., at 36-37.

In *Blair*, Mr. Justice Iacobucci noted that "persons are assumed to act in good faith unless proven otherwise."[147] He clearly placed the onus of showing that Mr. Blair did not act in good faith on the corporation. Under section 163.2, the onus of proof is always on the CCRA except where a valuation is outside the prescribed range referred to in subsection 163.2(10).[148]

The wording of the good faith provision does not indicate whether a subjective or objective intent is applied. In *Soper v. The Queen*,[149] Mr. Justice Marceau considered the standard of care of directors under subsection 227.1(3) of the Act and determined that the test was a hybrid "objective subjective standard." The standard is not based on the reasonable person (objective), but the reasonable person with the knowledge and experience of the particular individual (subjective).

A Cure?

While this comment may be considered heresy by the tax profession, one wonders whether the good faith defence really adds anything or whether it confuses the issue as it relates to excluded activities. Before the adviser can be subject to a penalty pursuant to subsection 163.2(2) or (4), the adviser must know that a statement is a false statement or the adviser would have known that a statement was a false statement but for culpable conduct. If an adviser has knowledge that a statement is a false statement, the good faith defence provided by subsection 163.2(6) is not available. Good faith can relieve an adviser of liability only where he or she does not have knowledge but has engaged in culpable conduct.

The language of subsections 163.2(2), (4), and (6) contemplates that an adviser can have made a false statement in circumstances amounting to culpable conduct but at the same time can have acted in good faith on information provided to the adviser.

As stated above,[150] most of the cases arising from section 163.2 will involve issues of fact. Once the facts are determined, the application of the section will be obvious. However, as a matter of theory, it is difficult to contemplate how an adviser could have committed conduct that is equivalent to intentional conduct, shown an indifference as to whether the Act is complied with, or shown a wilful, reckless, or wanton disregard of the law if the adviser had relied in good faith on information provided to him or her.

Subsection 163.2(7) provides that subsection 163.2(6) does not apply where an adviser makes, or participates in, assents to, or acquiesces in the making of, a statement in the course of an excluded activity.

147 Ibid., at 23, citing *General Motors v. Brunet*, [1977] 2 SCR 537, at 548.

148 Subsection 163(3).

149 97 DTC 5407 (FCA).

150 Supra footnote 46.

When the legislation was first introduced on September 10, 1999, the good faith defence did not extend to planning and valuation activities described in subsection 163.2(2).[151] The reason for this omission is found in the Department of Finance's view of the *Global* case. The department was concerned that each of two advisers could render a patently nonsensical opinion based in "good faith" on assumptions supported by the opinion of the other.[152] On the other hand, the joint committee was concerned that if an adviser did not have the ability in planning activities to rely on other advisers, the adviser could not demonstrate lack of culpable conduct. The resolution of these concerns was the insertion into the civil penalties legislation of the concept of "excluded activities." The Department of Finance concluded that the fisc is sufficiently protected by the provision for excluded activities because, in respect of these activities, advisers cannot rely on each other. The joint committee was of the view that this addition was an improvement, because it precluded the good faith defence only in respect of excluded activities. The amendment limited, but did not eliminate, the circumstances in which a good faith defence is unavailable.

The fallacy is the view of the Department of Finance that in circumstances similar to those in the *Global* case, advisers who had relied on each other's opinions could claim that such reliance was based on good faith. In view of the interdependence contemplated by the Department of Finance in *Global*, it is difficult to conclude that any adviser could have a bona fide belief in the values determined. Unfortunately, subsection 163.2(6) suggests that where there is no good faith defence because the activity is an excluded activity, the due diligence requirement must exceed that which would apply where there is a good faith defence.

Excluded Activity

The term "excluded activity" is defined[153] in respect of a false statement and consists of promoting or selling arrangements. An "arrangement" is defined for the purpose of the definition of culpable conduct as an arrangement, an entity, a plan, a property, or a scheme. An excluded activity means the activity of either promoting or selling,[154] or accepting consideration in respect of the promotion or sale,[155] of an arrangement. The activities of promoting or selling and accepting consideration can be performed either directly or indirectly, by a person acting as either principal or agent.

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151 Subsection 163.2(6) of the September 10, 1999 draft legislation: Canada, Department of Finance, *Legislative Proposals and Explanatory Notes Relating to Income Tax* (Ottawa: the department, September 1999).

152 Supra footnote 24 and the accompanying text.

153 Subsection 163.2(1).

154 Paragraph 163.2(1)(a).

155 Paragraph 163.2(1)(b).

An "arrangement" constitutes an "excluded activity" where it can reasonably be considered that

• subsection 66(12.68) applies to the arrangement;[156]

• the definition "tax shelter" in subsection 237.1(1) applies to a person's interest in the arrangement;[157] or

• one of the main purposes for a person's participation in the arrangement is to obtain a tax benefit.[158]

Subsection 66(12.68) requires a corporation that agrees to issue flowthrough shares,[159] or prepares a selling instrument[160] in respect of flowthrough shares, to file a prescribed form together with a copy of the selling instrument or agreement with the minister within a defined period of time.

A tax shelter is a property the cost of which may be deducted within four years of its purchase.

The term "tax benefit" is defined[161] to mean a reduction, avoidance, or deferral of tax or other amount payable under the Act, or an increase in a refund of tax or other amount under the Act. This definition is identical to the one in subsection 245(1) for purposes of the general anti-avoidance rule (GAAR). At the time the GAAR was proposed, critics pointed out the very broad definition of tax benefit. In response, subsection 245(4) was inserted, to limit the application of subsection 245(2). As stated by Howard Kellough at that time,[162] even something as mundane as a registered retirement savings plan (RRSP) comes within the definition of a tax benefit. Thus, for purposes of the civil penalties legislation, false statements made in respect of the promotion and sale of an RRSP could lead to penalties under subsections 163.2(2) and (4).

Because of the very broad wording of the tax benefit provision in subparagraph 163.2(1)(a)(iii), the real limitation to the definition of an excluded activity is that imposed by the words "promoting or selling" contained in the introduction to the definition. Consistent with the vagueness of language that permeates section 163.2, there is no definition of promoting or selling. At one end of the spectrum of possible activities, giving advice to a client should not be considered promoting or selling. At the other end of the spectrum, selling a scheme by

156 Subparagraph 163.2(1)(a)(i).

157 Subparagraph 163.2(1)(a)(ii).

158 Subparagraph 163.2(1)(a)(iii).

159 Defined in subsection 66(15).

160 Defined in subsection 66(15).

161 Subsection 163.2(1).

162 Howard J. Kellough, "A Review and Analysis of the Redrafted General Anti-Avoidance Rule" (1988), vol. 36, no. 1 *Canadian Tax Journal* 23-78, at 39.

means of a prospectus would be promoting or selling. It is not altogether obvious where one draws the line between these extremes. In informal meetings during the consultation process referred to earlier, representatives of the CCRA took the position that holding a seminar for the benefit of clients of a firm did not constitute promoting or selling. This is a helpful interpretation, although it is not necessarily in accordance with the words of the provision. A further complication is that many accounting and legal firms maintain marketing departments whose sole function is to help tax advisers "promote" themselves to clients and to "sell" services.

There remains an issue relating to the definition of "arrangement." Since paragraph (b) of the definition states that accepting consideration in respect of the promotion or sale of an arrangement is an excluded activity, the implication is that an arrangement includes, as part of the definition, all of subparagraphs (a)(i) to (iii).[163] If this were not the case, accepting consideration for any arrangement, entity, plan, property, or scheme would be an arrangement, and accepting consideration in respect of the promotion or sale of such arrangement would be an excluded activity, whether or not the activity satisfied the requirements of subparagraphs (a)(i) to (iii). This would result in virtually every activity being an excluded activity. Consequently, we suggest that the definition of arrangement should be interpreted as including subparagraphs (a)(i) to (iii).

Valuation

The value of a property or service is defined for the purposes of subsection 163.2(10) as the "stated value." As noted earlier, if the stated value of a property or a service is not within prescribed limits, the statement as to value made by the person who opined on that value, or by a person in the course of an excluded activity, is deemed to be a false statement that the person could reasonably be expected to know, but for circumstances amounting to culpable conduct, was a false statement. A person making a statement of value that is not within the prescribed limits is not permitted the benefit of the good faith defence,[164] nor is the onus on the minister in this situation to prove the basis for assessing a penalty pursuant to subsection 163.2(2) or (4).[165]

How broad is the meaning of the phrase "statement as to the value of a property or a service"? For example, is a form T2057 filed in connection with a transaction considered to be such a statement?

In the context of activities that are not excluded activities, a statement is one made by a person who opined on the stated value. In these circumstances, the

163 See *ITT Industries of Canada Limited v. The Queen*, 2000 DTC 6445 (FCA), for an example in which this interpretation was rejected.

164 Subsection 163.2(6).

165 Subsection 163(3).

word "statement" should be given a technical meaning,[166] so that the phrase "statement as to the value of a property or service made by the person who opined" refers to a formal opinion or valuation and not to a casual comment as to value. The word "opine" should be interpreted in a manner consistent both with the purpose of the legislation, which is to penalize flagrant disregard of a professional's duties, and with the administrative principles articulated by the CCRA.[167]

In response to example 4, the CCRA suggested that Mr. Z might be subject to penalties if his valuation were not reasonable and were not based on reasonable assumptions that were not misleading.[168] On the facts, it is difficult to see why Mr. Z should be subject to penalties. He provided what purported to be a preliminary estimate of value. There is no indication that he gave a formal opinion as to value. It could hardly be said that he was negligent, let alone that he made a statement in circumstances constituting culpable conduct.

Where the statement is made in the context of an excluded activity, there is no requirement that the person making the statement opine on the stated value. However, to give the term "statement" a meaning that is consistent with both excluded and non-excluded activities, it should be limited to statements made in the course of creating and implementing the excluded activity, and not to comments made or actions taken that are peripheral to the activity. Under this interpretation, where an accountant merely files a form T2057 in connection with an excluded activity carried out by her client, and the accountant did not devise the scheme, she should not be considered to have made a statement as to the value of a property or service.

Similarly, we suggest that the words "in the course of an excluded activity" be given a narrow meaning, consistent with the purpose of the legislation. A person should be subject to penalties for making a statement where the person performed an act that is relevant to the furtherance of the offensive activity and not simply an administrative function. Therefore, the accountant in the foregoing paragraph should not be considered to have made a statement in the course of an excluded activity. In *Blok-Andersen v. MNR*, Mr. Justice Cattanach interpreted the phrase "in the course of" as follows:

> The phrase "in the course of" contemplates a succession of events in a regular order. It also contemplates a result which follows from an event being set in motion.[169]

Subsection 163.2(11) provides for an exception to subsection 163.2(10), which applies where the person establishes that the stated value was reasonable

166 An example of a case in which a court gave a technical interpretation as opposed to a more broadly based interpretation is *Will-Kare*, supra footnote 5.

167 Set out in the text accompanying footnote 70, supra.

168 Supra footnote 132.

169 72 DTC 6309, at 6321 (FCTD).

in the circumstances and that the statement was made in good faith. In addition, where applicable, for the exception in subsection 163.2(11) to apply, the person must establish that the stated value was not based on one or more assumptions that the person knew, or would reasonably be expected to know, but for circumstances amounting to culpable conduct, were unreasonable or misleading in the circumstances.

Subsection 163.2(10) does not state that if the value is within the parameters set out in paragraphs 163.2(10)(a) and (b), the person has not made a false statement either knowingly or in circumstances amounting to culpable conduct. There is, however, an inference that can be drawn from subsections 163.2(10) and (11) that a valuation that fits within those parameters is acceptable and does not constitute a false statement. In such circumstances, it may be argued that subsection 163.2(10) provides for a safe harbour. The recent case of *65302 British Columbia Ltd. v. The Queen*[170] is illustrative, although it may not be completely analogous. In that case, the Supreme Court of Canada decided that penalties imposed for the production of eggs above a fixed quota were deductible. The court based its conclusion on the existence of section 67.5, which indicated that Parliament had turned its mind to the issue and had legislated in respect of those penalties that were not deductible.[171]

Until the regulations promulgating the valuation limits contemplated by subsection 163.2(10) are issued, it will be difficult to draw a conclusion as to whether that provision provides a safe harbour. As described above, a false statement is one that is misleading as opposed to inaccurate. Very few statements are precisely accurate. Where valuations are concerned, there is some range as to what the "true" value is. If the parameters are quite broad, there will undoubtedly be situations in which the facts will indicate quite clearly that there has been a false statement notwithstanding that the valuation falls within the parameters. However, if the parameters are such that it is not obvious that a statement within the parameters can still be false, the courts may conclude that such a valuation cannot amount to a false statement. In any event, given the difficulty that a judge will have in determining how inaccurate a statement needs to be in order to be considered a false statement, in most circumstances, one would anticipate that a judge will conclude that if a valuation falls within the prescribed limits, the valuation will not constitute a false statement. The result may be that the courts will not conclude as a matter of law that a statement within the parameters can never be a false statement, but may nevertheless be reluctant to conclude that the statement is a false statement where the valuation is within the parameters. Consequently, subsection 163.2(10) will effectively constitute a safe-harbour provision regardless of what the courts say about it as a matter of legal theory.

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170 99 DTC 5799 (SCC), rev'g. 98 DTC 6002 (FCA), rev'g. 96 DTC 2049 (TCC).

171 See Mr. Justice Iacobucci's comments, ibid., at 5812 (SCC).

It is the CCRA's view that subsections 163.2(10) and (11) are merely onus-shifting provisions. Accordingly, if subsection 163.2(10) is applicable because the valuation is not within the prescribed limits, the person has the onus to establish that the relevant statement is not false. In contrast, where the valuation is within the prescribed limits, the onus to show that the statement is false shifts to the minister. For the reasons described below, there are a number of difficulties with the CCRA's view.

In theory, who has the onus is quite significant. In *Hickman Motors Limited v. The Queen*, Madam Justice L'Heureux-Dubé stated:

> The Minister, in making assessments, proceeds on assumptions (*Bayridge Estates v. M.N.R.*, 59 DTC 1098 (Ex. Ct.), at p. 1101) and the initial onus is on the taxpayer to "demolish" the Minister's assumptions in the assessment (*Johnston v. M.N.R.*, [1948] S.C.R. 486; *Kennedy v. M.N.R.*, 73 DTC 5359 (F.C.A.), at p. 5361). The initial burden is only to "demolish" the exact assumptions made by the Minister *but no more*: *First Fund Genesis v. The Queen*, 90 DTC 6337 (F.C.T.D.), at p. 6340.
>
> This initial onus of "demolishing" the Minister's exact assumptions is met where the appellant makes out at least a *prima facie* case: *Kamin v. M.N.R.*, 93 DTC 62 (T.C.C.); *Goodwyn v. M.N.R.*, 82 DTC 1679 (T.R.B). . . .
>
> Where the Minister's assumptions have been "demolished" by the appellant, "*the onus shifts to the Minister to rebut the prima facie case*" made out by the appellant and to prove the assumptions: *Maglib Development Corp. v. The Queen*, 87 DTC 5012 (F.C.T.D.), at p. 5018.[172]

In practice, the question of onus seldom influences the outcome.[173] In *The Cadillac Fairview Corporation Limited v. The Queen*, His Honour Judge Bowman stated:

> An inordinate amount of time is wasted in income tax appeals on questions of onus of proof and on chasing the will-o'-the-wisp of what the Minister may or may not have "assumed". . . . The usual rule—and I see no reason why it should not apply in income tax appeals—is set out in Odgers' *Principles of Pleading and Practice*, 22nd edition at p. 532:
>
>> The "burden of proof" is the duty which lies on a party to establish his case. It will lie on A, whenever A must either call some evidence or have judgment given against him. As a rule (but not invariably) it lies upon the party who has in his pleading maintained the affirmative of the issue; for a negative is in general incapable of proof. *Ei incumbit probatio qui dicit, non qui negat*. The affirmative is generally, but not necessarily, maintained by the party who first raises the issue. Thus, the onus lies, as a rule, on the plaintiff to establish every fact which he has assured in the statement of claim, and on the defendant to prove all facts which he has pleaded by way of confession and avoidance, such as fraud, performance, release, rescission, etc.[174]

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172 97 DTC 5363, at 5376-77 (SCC).

173 See *Gross v. MNR*, 89 DTC 660 (TCC), for an example of a case in which the outcome did depend on onus.

174 97 DTC 405, at 407, footnote 2 (TCC), aff'd. 99 DTC 5121 (FCA).

In practice, it is difficult to conclude that subsections 163.2(10) and (11) simply serve as onus-shifting provisions. Without casting aspersions on the legislative drafters, if this was the intent, the legislation probably has not been thoroughly reviewed by anyone with trial advocacy experience. Where there is an onus-shifting provision, such as subsection 163(3), the parties to the litigation are aware of who has the onus at the beginning of the presentation of the evidence and can prepare their case accordingly. Where subsections 163.2(10) and (11) are in issue, in most instances, the parties will not know who has the onus at the time of the presentation of evidence.

Subsections 163.2(10) and (11) contain no procedural provisions; they do not require that the parties must determine what fair market value is before the case commences and therefore how the stated value compares to the fair market value and the prescribed limits.

Section 173 permits the minister and a taxpayer to apply to have the court consider a preliminary question of law, fact, or mixed law and fact. Consequently, the parties could apply to the court to determine the fair market value before proceeding to determine the other issues in dispute. However, section 173 is voluntary, and the application of this provision makes any trial process in most circumstances more cumbersome. In most cases, the parties would not have a trial to determine fair market value and a subsequent trial to determine all the other issues.

Before a court can conclude that subsection 163.2(10) applies, it must determine the fair market value, based on the evidence. It will be the minister's position that the valuation falls outside the prescribed limits. In most circumstances, the adviser's position will be that the valuation falls within the prescribed limits. Few cases will proceed on the basis that the only issue is the relationship of stated value to fair market value. In most circumstances, also at issue will be whether there has been a false statement and whether the adviser has made it knowingly or in circumstances constituting culpable conduct. At trial, each party will present all the relevant evidence of its case. The adviser will lead evidence exculpating himself or herself, and the Crown will lead evidence to establish that the adviser is subject to penalties. A judge will have heard all of the evidence before he or she makes a determination as to what a fair market value is. Only when the judge has determined the relationship of fair market value to stated value will it be known who has the onus. However, at that time, the issue of onus will most likely be moot. From a practical perspective, the onus-shifting nature of subsections 163.2(10) and (11) will be irrelevant.

If the CCRA's position is correct, even if the value falls within the prescribed limits, the court will still have to determine whether the adviser is subject to subsection 163.2(2) or (4).

Regardless of the nature of subsections 163.2(10) and (11), if a court determines that the stated value is not within the prescribed range, the court will have to consider the application of subsection 163.2(11). It will have to determine whether the stated value is reasonable in the circumstances and made in good faith. The greater the spread between the fair market value and the stated value, the more difficult it will be for the adviser to substantiate that the valuation was reasonable in the circumstances and made in good faith.

If the CCRA's position is correct, subsection 163.2(10) is inapplicable if the adviser satisfies the elements of subsection 163.2(11), and the onus is on the minister to prove the elements referred to in subsection 163.2(2) or (4). However, it would be in very unusual circumstances that a court would conclude that an adviser met the criteria of subsection 163.2(11) and at the same was subject to penalties pursuant to either subsection 163.2(2) or (4). For an adviser to satisfy the provisions of subsection 163.2(11), the adviser must establish that the stated value was reasonable in the circumstances and was made in good faith. It is unlikely that a stated value can be reasonable and at the same time be a false statement. It is also highly unlikely that the adviser can make a statement in good faith and at the same time have engaged in culpable conduct. Similarly, if the adviser can establish that he or she did not make the statement based on one or more assumptions such that he or she knew, or could reasonably be expected to know, but for circumstances amounting to culpable conduct, that the assumptions were unreasonable or misleading in the circumstances, it would be unusual for a court to conclude that the adviser knowingly made a false statement or made a false statement in circumstances amounting to culpable conduct.

Subsection 163.2(11) uses the nebulous phrases "good faith" and "reasonable." The concept of good faith has been discussed above. Although the Act uses the term "reasonable" (in section 67), or derivatives thereof (for example, "reasonably" in the definition of "term preferred share" in subsection 248(1)), there is little jurisprudence that is helpful in defining the term. The leading case on the meaning of "reasonable" is still *Gabco Ltd. v. MNR*.[175] In *Gabco*, the appellant was a family-owned construction company. It was the successor of another construction company that had been created by the father of the appellant's two principal shareholders. At age 19, one of these shareholders was hired by the appellant's president with the intention of making him his number two man. In keeping with the appellant's practice of paying its permanent employees, the remuneration received by this shareholder-employee was largely in the form of bonus payments. In assessing the appellant for the 1962 and 1963 taxation years, the minister disallowed the deduction of most of this remuneration on the basis that it was unreasonable in light of the shareholder-employee's youth, his record of academic failures, and the fact that his earnings for three months in 1962 exceeded the superintendent's salary for that year.

175 68 DTC 5210 (Ex. Ct.).

In allowing the appeal, Mr. Justice Cattanach for the Exchequer Court enunciated the following, now famous statement with respect to reasonableness:

> It is not a question of the Minister or this Court substituting its judgement for what is a reasonable amount to pay, but rather a case of the Minister or the Court coming to the conclusion that no reasonable business man would have contracted to pay such an amount having only the business consideration of the appellant in mind.[176]

Penalties

Where a person is liable to a penalty in respect of a false statement referred to in subsection 163.2(2), the quantum of the penalty is determined pursuant to subsection 163.2(3). Where the statement is made in respect of the course of a planning activity or a valuation activity, the penalty is 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 or valuation activity. The reference to the gross entitlements at the time of the assessment takes into account the possibility that a person's entitlement might later change. This issue is dealt with more fully in the discussion of subsection 163.2(12) below. In any case other than a planning activity or a valuation activity, the penalty is $1,000.

"Gross entitlements" of a person in respect of a planning activity or a valuation activity is defined in subsection 163.2(1) to mean all amounts to which the person, or another person not dealing at arm's length with the person, is entitled. They include amounts to which the particular person, or any person not dealing at arm's length with the particular person, is entitled, either before or after that time, and either absolutely or contingently, to receive or obtain "in respect" of the activity.

This definition of "gross entitlements" is very broad. As discussed earlier, the words "in respect of" have been given a very expansive meaning.[177] For example, if a law firm participates in the offer of a security by way of a prospectus that contains a false statement prepared by a tax adviser and the partnership is assessed under section 163.2, the gross entitlements may include the entire fee of the partnership for the preparation of the prospectus, notwithstanding that the portion of the fee attributable to the false statement may be only a fraction of that amount.

Where an individual is a member of a partnership and is assessed personally, the Act gives no guidance as to the method of determining the person's gross entitlements in respect of the planning activity or valuation activity. While occasionally a tax adviser will render a separate account for services that he or she provides, the tax adviser will not be personally entitled to that amount but

176 Ibid., at 5216.

177 See the quote accompanying footnote 67, supra.

will be required to account to the partnership for it. In this situation, the account would not be a measure of the adviser's gross entitlements. More frequently, there will simply be one account rendered by the partnership, which will include the services performed by the tax adviser. The value of the adviser's accrued time, subject to adjustment to reflect any premium or discount on the account, is also not a measure of the adviser's entitlement because the partner has no right to keep such amount but must account to the partnership for it. Because of the lack of guidance in the Act, a court may conclude that the partner's gross entitlements from the transaction are that proportion of the partnership's account that the partner's net income from the partnership is of the partnership's income for the relevant year. This conclusion would be rough justice because it might overstate or understate the partner's contribution to the partnership's account in respect of the transaction. Moreover, where the partner's share of the income is partly dependent upon a discretionary allocation by the partnership's executive, there is an even more tenuous relationship between the gross entitlements of the individual and the amount of the account of the partnership.

Subsection 163.2(5) provides that where a person is liable to a penalty under subsection 163.2(4) in respect of a false statement, the person is subject to a penalty that is the greater of

(a) $1,000, and

(b) the lesser of:

(i) the penalty which the other person would be liable for 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.

"Gross compensation" is defined in subsection 163.2(1) similarly to gross entitlements, but not as broadly. Gross compensation of a particular person at any time in respect of a false statement means all amounts to which the particular person, or any person not dealing at arm's length with a particular person, is entitled, either before or after that time, and either absolutely or contingently, to receive or obtain "in respect of" the statement.

The definition of gross compensation refers to amounts to be received or obtained in respect of a statement and not in respect of the activity. Therefore, what constitutes gross compensation may be less than what constitutes gross entitlements. In the example given above of a law firm preparing a prospectus, the gross compensation in respect of the statement of an accounting firm preparing a return and aware of the false statement would be the fee allocable to the preparation of the statement.

Subsection 163.2(8) limits the penalty for the purposes of subsections 163.2(2) and (3), but not for the purposes of subsections 163.2(4) and (5). Paragraph

163.2(8)(a) provides that where a person makes, furnishes, participates in making, or causes another person to make or furnish two or more false statements, the false statements are deemed to be one false statement if the statements are made in the course of

- one or more planning activities that are in respect of a particular arrangement, entity, plan, property, or scheme; or
- a valuation activity that is in respect of a particular property or service.

By virtue of subsection 163.2(8), where a number of false statements are made within the course of a planning activity or a valuation activity, there is deemed to be only one false statement so that there is only one penalty.

Paragraph 163.2(8)(b) provides a rule for greater certainty to define the ambit of a particular arrangement, entity, plan, property, or scheme. A particular arrangement, entity, plan, property, or scheme (for convenience, referred to in this article as "a particular arrangement") includes an arrangement, entity, plan, property, or scheme (in this article referred to as "a subject arrangement") if the subject arrangement satisfies one of the tests referred to in subparagraphs 163.2(8)(a)(i), (ii), and (iii). These tests are similar to the tests referred to in subparagraphs (a)(i) to (iii) of the definition of excluded activity.

Each of subparagraphs 163.2(8)(b)(i) to (iii) refers to excluded activities. Where an arrangement is not an excluded activity, it will be a question of fact whether a subject arrangement is part of a particular arrangement. Subparagraph 163.2(8)(b)(i) requires that for the subject arrangement to be included in a particular arrangement, each of the subject arrangement and the particular arrangement must be a tax shelter that has the same identification number. Under subparagraph 163.2(8)(b)(ii), a subject arrangement is part of a particular arrangement if each is a selling arrangement in respect of flowthrough shares which is required to be filed with the minister because of subsection 66(12.68). There is no requirement that a subject arrangement and a particular arrangement be part of the same selling instrument. Subparagraph 163.2(8)(b)(iii) requires that one of the main purposes for the person's participation in each of the subject arrangement and the particular arrangement is to obtain a tax benefit. There is no other connection between the two, although there would have to be some factual connection for the subject arrangement to be part of the particular arrangement.

Subsection 163.2(8) has no application to subsections 163.2(4) and (5). It is understood from informal discussions with the CCRA[178] that it was intended that tax preparers who have demonstrated a course of conduct of recommending certain schemes (such as claiming inappropriate automobile expenses, as described above under the heading "Background—Intent of the Legislation") would be assessed a separate penalty for each tax return in which they utilize the scheme.

178 Supra footnote 34.

Subsection 163.2(12) provides special rules addressing situations in which a person's gross entitlements or gross compensation changes subsequent to the issuance of an initial assessment. Paragraph 163.2(12)(a) contemplates the situation in which a person is assessed a penalty pursuant to subsection 163.2(2), the amount of which is based on his or her gross entitlements at any time in respect of a planning activity or valuation activity and the person's gross entitlements subsequently change. Where the person's gross entitlements are greater at that later time, the assessment of the penalty made at that later time is deemed to be an assessment of a separate penalty. In any other case, the notice of assessment of the penalty sent before that later time is deemed not to have been sent. In these circumstances, the person's previous assessment will be vacated and a new assessment issued.

Paragraph 163.2(12)(b) provides that a person's gross entitlements in respect of any planning activity or valuation activity exclude the total of all amounts each of which is the amount of the penalty (other than the penalty the assessment of which is void because of subsection 163.2(13))[179] determined under paragraph 163.2(3)(a) in respect of the false statement for which notice of the assessment was sent to the person before the time referred to in paragraph 163.2(12)(a). Paragraph 163.2(12)(b) refers back to subparagraph 163.2(12)(a)(i) and ensures that the new assessment is only for those gross entitlements that have not previously been subject to the imposition of penalties.

The language of subsection 163.2(12) could be clearer and more symmetrical. Paragraph 163.2(12)(c) is not the mirror image of paragraphs 163.2(12)(a) and (b). Paragraph 163.2(12)(c) provides that where a person is assessed a penalty that is referred to in subsection 163.2(4), the person's gross compensation at any time in respect of the false statement shall exclude the total of all amounts, each of which is the amount of a penalty determined under subsection 163.2(5) to the extent that the false statement was used by or on behalf of the other person and for which notice of the assessment was sent to the person before that time. Paragraph 163.2(12)(c) contemplates the issuance of additional assessments if it is determined that the gross compensation is greater. It does not explicitly contemplate the voiding of the previous assessment and the issuance of a new assessment if gross compensation is less. However, it does refer to subsection 163.2(13).

Subsection 163.2(13) provides that if an assessment of a penalty referred to in subsection 163.2(2) or (4) is vacated, the assessment is deemed to be void. The significance of this provision is that subsections 165(1.1) and (7) do not apply. Consequently, the notice of objection to the subsequent assessment is not one that is subject to the limitations imposed upon the adviser pursuant to paragraph 165(1.1)(a) or that permits the adviser to appeal to the Tax Court of Canada.

179 Described below.

As described above, the CCRA views subsection 163.2(2) as applying to planning and valuation activities and subsection 163.2(4) to reporting activities. Notwithstanding this bright-line division contemplated by the CCRA, the wording of the two penalty provisions provides for substantial overlap. As a result of such overlap, subsection 163.2(14) provides that where a person is liable to a penalty under each of subsections 163.2(2) and (4) in respect of the same false statement, the person is liable to a penalty of not more than the greater of the total amount of the penalties for which he or she is liable under subsection 163.2(2) in respect of the statement and the total amount of the penalties for which he or she is liable under subsection 163.2(4) in respect of the statement.

Exceptions

Subsection 163.2(9) provides that a person is not considered to have made, furnished, or participated in, assented to, or acquiesced in the making of, a false statement solely because the person provided clerical services or secretarial services with respect to the statement. A person providing bookkeeping services does not enjoy the exception for clerical services.

One of the initial criticisms of the legislation was that it subjected employees to the civil penalties, although employees might be under significant compulsion to file tax returns or participate in planning in order to maintain their employment.[180] As a result of various submissions made to the Department of Finance, subsection 163.2(15) was inserted so that the civil penalty provisions in general did not apply to employees. An employee employed by the other person referred to in subsections 163.2(2) and (4) is not subject to the provisions of subsections 163.2(2) to (5), which are the charging and computation provisions.

There are a number of very significant limitations on the exception provided by subsection 163.2(15). First of all, a "specified employee"[181] does not benefit from this provision. Presumably, the rationale is that a specified employee has a significant equity stake in the other person and is more akin to a partner of a professional firm than to an employee. Second, no employee of a person engaged in an excluded activity benefits from the exclusion provided for by subsection 163.2(15). As described above, the definition of excluded activity is quite broad, and therefore in many circumstances employees will not have the protection of subsection 163.2(15). Presumably, this distinction was made because those who engage in excluded activities are the very people at which the legislation is aimed, and the Department of Finance did not want persons engaged in excluded activities to avoid penalties through the use of the employment exception. However, the result is that in many instances employees who have no input in the decision to carry out an excluded activity will be subject to the provisions of section 163.2.

180 See Nichols, supra footnote 2, at 42-43.

181 Defined in subsection 248(1).

It is only an employee of the other person who is entitled to the benefit of subsection 163.2(15). For example, assume that corporation A has a number of subsidiaries, one of which is corporation B. The outside tax advisers devise a scheme to save corporation A and its subsidiaries significant tax. The accountant of corporation A prepares the tax return of corporation B. The other person, in these circumstances, is corporation B. However, the employee is the employee of corporation A. The employee, in such circumstances, cannot claim the benefit of subsection 163.2(15) with respect to a false statement in the return of corporation B.

Where subsection 163.2(15) applies, the conduct of the employee is deemed to be that of the other person for the purposes of applying subsection 163(2) to the other person. This provision enables the CCRA to reassess the other person under subsection 163(2). When it was pointed out to the CCRA that there is an inherent unfairness in the lack of safeguards for the employee of corporation A in the example in the previous paragraph, the CCRA stated that it could not use subsection 163.2(2) to assess corporation A for the misconduct of the activities of the employee in connection with the activities of corporation B. While the CCRA is undoubtedly technically correct, this is small solace to the employee of corporation A in these circumstances.

CONCLUSION

The civil penalties legislation is far broader than is needed to cure the abuses at which the auditor general and the Department of Finance were aiming. Even if one begrudgingly accepts the necessity of the legislation, it is unfortunate that with respect to planning activities, the legislation is not limited to "excluded activities" and with respect to reporting activities, it is not limited to those who counsel false reporting.[182]

The Department of Finance has always maintained that the legislation is intended to apply only to the most egregious situations.[183] The retort of the profession has always been that if the Department of Finance wants to pursue only the egregious situations, it has the power to do so under section 239 without creating a whole new set of civil penalty provisions. The profession's concern is that the history of section 163.2 will follow the history of section 227.1 (liability of directors for failure to deduct). When section 227.1 was first enacted, it was understood that it would be used only in flagrant circumstances. It was aimed

182 It has been suggested to us that such activities are already covered by section 239. This is precisely the point we make at footnote 33, supra, and immediately below. The legislation is not needed. Section 239 exists to enable the government to prosecute those situations which the Department of Finance, by its own account, really wishes to challenge. If it wishes to subject additional transactions to penalties, the legislation is broader than warranted.

183 See the transcript of Jerry Lalonde's comments, supra footnote 14, at 18:10.

primarily at shell construction companies that started up a business for a project and were dissolved immediately after the completion of the project. However, section 227.1 is unfailingly applied whenever there is an insolvency or bankruptcy.

The drafting of the civil penalties provisions leaves much to be desired; they are permeated with vague and imprecise words. Because the legislation is quasi-penal in nature and requires an adviser either to know that a statement is false or to be in a position where he or she could reasonably be expected to have known, but for culpable conduct, that a statement is false, we have suggested that the courts give the legislation a purposive interpretation and not a literal one. We are, ourselves, professional advisers, and it is our ideal that the legislation will never be applied. Since this result is unlikely, we can only wait to see how the courts will ultimately interpret the various civil penalty provisions.