THIRD PARTY PENALTIES UNDER THE *INCOME TAX ACT* SURVIVE CONSTITUTIONAL CHALLENGE

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On July 31, 2015 the Supreme Court of Canada ("**SCC**") released its much anticipated decision in the *Guindon*[1] case confirming the constitutionality of the penalty regime contained in section 163.2 of the *Income Tax Act* (the "ITA") for third-parties who make, or participate in the making of, false statements for use by taxpayers to reduce their tax liability under the ITA. The regime provides for, potentially, very significant penalties for third parties who make such false statements in circumstances amounting to culpable conduct.

Background

Ms. Guindon (the "**Appellant**") was a lawyer who provided a legal opinion on a tax-motivated donation program called the Global Trust Charitable Donation Program (the "**Program**"). Under the Program, participants would acquire timeshare units of and would donate those units to a charity at a fair market value greater than their cash payment for the timeshare units. The legal opinion was based on a precedent provided by the Program's promoters, and the Appellant advised the promoters to have it reviewed by a tax professional, as it did not fall within her area of expertise.

The Appellant was also the president and administrator of a registered charity that became involved with the Program, even though, as the SCC ultimately concluded, the Program was a sham, and no timeshare units were created or donated to the charity. In that capacity she signed 135 tax receipts, which had been prepared by the promoter, acknowledging the donation of units in the total receipted amount of $3,972,775. The Minister of National Revenue (the "**Minister**") assessed the Appellant for penalties of $546,747 under section 163.2 of ITA on the grounds that she knew or would have known, but for her wilful disregard of the ITA, that the tax receipts constituted false statements.

Case History

At her initial trial, the Tax Court vacated the Minister's assessment and allowed the Appellant's appeal on the basis that the third-party civil penalty provisions in section 163.2 of the ITA were criminal in nature and entitled the taxpayer to fundamental substantive and procedural legal rights under section 11 of the *Charter of Rights and Freedoms* (the "***Charter***").

The Federal Court of Appeal (FCA) overturned the decision of the Tax Court on two grounds. First, on procedural grounds, the FCA concluded that the Tax Court lacked jurisdiction to decide the constitutional question, since notice of a constitutional question was not provided by the Appellant at the trial level. Second, on substantive grounds, citing earlier SCC jurisprudence, the FCA held that section 163.2 was not criminal in nature, such that section 11 of the Charter did not apply.

SCC Decision

Justice Rothstein and Cromwell, writing for the majority, followed the earlier SCC jurisprudence and upheld the decision of the FCA on the basis that the traditional hallmarks of a criminal proceeding were not present in a section 163.2 proceeding. Unlike a criminal proceeding, the imposition of a penalty under section 163.2 does not result in a person being charged, arrested or summoned to appear before a court of criminal jurisdiction. Rather, a CRA auditor conducts a penalty audit, advises the individual in writing of the audit, and consider any representations the individual may make before imposing the penalty. The provisions are administrative in nature in that they encourage compliance that is integral to the ITA's regulatory regime.

In the majority's view the proceedings do not lead to the imposition of any "true penal consequence". While recognizing that the penalties in this case were very high, particularly for an individual, the majority concluded that the amount of the penalty on its own is not determinative – significant penalties may be necessary to deter non-compliance with an administrative scheme.

Although not disagreeing with the result in this case, the minority would have denied the appeal on the basis that the Appellant's failure to give notice of a constitutional question in the Tax Court, precluded her from challenging the constitutionality of section 163.2.

Moral of the story

Beyond the obvious lesson - that lawyers should not give opinions on subjects outside their area of expertise - the case has important implications for persons involved in tax planning or the preparation of tax returns or tax receipts. If they make or participate in the making of, statements that they know, or should know but for their "culpable conduct", are false, they could be liable for potentially significant penalties.

This decision also has broader implications for administrative penalties under other legislative regimes. Similar penalties are imposed for GST/HST purposes under the *Excise Tax Act*, and civil penalties of a similar (or greater) magnitude are permitted under, for example, the *Securities Act* (Ontario).

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A Cautionary Note

1 Guindon v R, 2015 SCC 41.