DEVRY SMITH FRANK *LLP*
Lawyers & Mediators

Eldad.gerb@devrylaw.ca
416.446.3327

By Email finapbc-cpb@parl.gc.ca

August 6, 2014

Christine Lafrance, Clerk of the Standing Committee on Finance
Sixth Floor, 131 Queen Street
House of Commons
Ottawa ON K1A 0A6
Canada

To the Honourable Standing Committee on Finance:

Re: Pre-Budget Consultation Process

Executive Summary

370 Canadian taxpayers across Canada each invested on average tens of thousands of dollars into *Partners In Research ("PIR")*, a business losses tax fraud that has been under investigation by the Canada Revenue Agency since November 2012. Our law firm acts for 32 of those taxpayers.

In accordance with the Standing Committee's focus on six key themes in the 2015 consultation process, our submissions pertain to: supporting families and helping vulnerable Canadians by focusing on health, education and training [in financial literacy]; increasing the competitiveness of Canadian businesses through research, development, innovation and commercialization, and; improving Canada's taxation and regulatory regimes.

The PIR fraud was based on the Government of Canada's Scientific Research and Experimental Development ("SR&ED") Program, the largest single source of federal government support for industrial R&D. The Government of Canada has a duty and obligation to ensure that SR&ED-style tax fraud does not undermine the administration and objectives of the SR&ED Program. The taxpayers that invested were victims of a sophisticated fraud and now face repayment and penalties with dire financial consequences; many are forced to explore or voluntarily petition themselves into bankruptcy.

While the Minister has taken a number of measures to combat tax frauds, they continue to proliferate. It is obvious that more could and should be done in this area to protect both Canadian taxpayers and the Canadian taxation system from base erosion, misuse and abuse. It is imperative for the improvement, fairness and justice of Canada's taxation regime that the 2015 federal budget strengthen protections for Canadian taxpayers *before* and *after* they fall victim to tax

fraud. Furthermore, it is our goal to work with the Government of Canada to promote financial literacy and bring greater awareness to the types of tax frauds in the marketplace.

Facts Supporting Our Submission

Tax Fraud in Canada

A report prepared by the Tax Justice Network in 2011 estimated that Canada loses approximately $80 billion dollars per year to all forms of tax evasion and fraud. Business losses fraud, considered by the CRA to be one of the five most prevalent types of fraud in Canada – along with natural person v. legal person fraud, RRSP fraud, charity receipting fraud and precious gems fraud – is particularly harmful when SR&ED-like principles are overlaid on top of it.

Tax Fraud Patterns

Too often, the narratives of these taxpayers follow an unenviable though understandable progression. Enticed by offers of legitimate and affordable tax planning, unsophisticated and hardworking taxpayers place their trust and finances in the care of third parties holding themselves out as experts. Often these taxpayers are referred to these third parties by unwitting friends and families who themselves have unknowingly been duped. Only years later, once the CRA has audited these taxpayers' returns, do the taxpayers become aware of the true nature of their participation. Humiliated, embarrassed and victimized, these taxpayers are penalized still further by the enforcement action taken against them by CRA.

Targeting Taxpayers

It is apparent that these third parties prey on a discrete, identifiable group of taxpayers. Most victims of tax fraud receive T4 employment income, and thus have no knowledge of the tax and reporting implications of owning a business. While the educational backgrounds of the taxpayers can range from secondary school to graduate levels, nearly all have only a minimal understanding of even the most basic ins-and-outs of the Canadian tax system. Invariably, the taxpayers are victims of previous tax frauds because often times the new tax frauds are predicated on *disputing* or *correcting* previous tax frauds. PIR presents as an unfortunate though characteristic example of how these tax frauds progress.

Brief Overview of PIR

In 2010 and 2011, 370 Canadian taxpayers invested in PIR, which was marketed as providing legitimate investments into new start-ups leveraging the *idea* of the federal government's widely publicized SR&ED Program.

In addition to investment, PIR representatives would prepare taxpayers' tax filings for the current taxation year and three previous years; notably, the three previous years covered the Global Learning Gifting Initiative or GLGI, a registered tax shelter that issued charitable donation receipts to participants on a levered basis, which is presently before the Tax Court of Canada.[1] Unbeknownst to investors, PIR was a well-orchestrated fraud, perpetrated by a figure well-

[1] *Moshurchak, Douglas,* (2009-3516(IT)G)

known to the CRA.[2] Nevertheless, it was only in 2013 and going forward that the CRA began to alert taxpayers as to the true nature of their involvement in PIR. By this point, many of the taxpayers had already invested a second time and had spread the word to neighbours and family members, who themselves became victims of PIR.

As a result of their investigation into PIR, the CRA found the Taxpayers liable under s.163(2) of the *Income Tax Act,* and various other provincial counterparts. Section 163(2) provides, in part:[3]

> *(2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a "return") filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty[.]*

The results of the CRA's investigation only served to compound and exacerbate the precarious financial position the taxpayers were in. In addition to the loss of their initial investment, which in some cases was borrowed funds to begin with, the taxpayers were now liable for penalties and interest which ran into the tens of thousands of dollars. In many cases, these penalties have overwhelmed the taxpayers and resulted in bankruptcy. While s.163(2) of the *Act* provides a powerful *quasi-criminal*[4] tool for the Minister to prosecute those who intend to misrepresent their financial position to minimize tax liability, it is our submission that the victims of sophisticated tax frauds do not fall within Parliament's intention of gross negligence penalties.

Law Supporting our Submission

In *Venne v. The Queen,* a cornerstone of the jurisprudence under s.163(2), the Federal Court described s.163(2) as requiring, "greater neglect than simply a failure to use reasonable care [and] a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not."[5] More recently, Justice Bowman described s.163(2) as "descriptive of an exceptionally high degree of negligence, amounting almost to recklessness. It goes well beyond mere inadvertence."[6] As well, the Tax Court has held that "subsection 163(2) implies a requirement of intent to conceal a taxation transaction [and b]ecause subsection 163(2) is penal in nature, the provision merits a higher degree of culpability and must be imposed only where the evidence clearly justifies it."[7] In *Vachon,* the Tax Court of Canada held that the "basis for imposing the penalty [under s.163(2)] is closer to a criminal law concept"[8] and that "imposing penalties requires negligence to the extent that the alleged carelessness is significant and reckless enough that it is possible to detect some degree of complicity."[9]

---

[2] *Thelwell v. The Queen*, 2012 TCC 32
[3] *Income Tax Act*, RSC 1985 c 1 (5th Supp), s.163(2)
[4] *Vachon v R*, 2013 TCC 330 at para 78 [*Vachon*]
[5] *Venne v. R..*, [1984] C.T.C. 223 at 234 (FCTD)
[6] *Contonis v. R,* (1995), 95 DTC 511 (TCC)
[7] *Dao v. R.*, 2010 TCC 84, 2010 D.T.C. 1086 at para 39
[8] *Vachon* supra at para 78
[9] *Vachon,* supra at para 79

It becomes clear from the above passages that Parliament's intent under s.163(2) was to set a high bar for liability on the premise that the penalties imposed under the section were punitive and harsh. For at least thirty years, the courts faithfully applied the law under s.163(2) in a manner consonant with this intent.

In late 2013, the Tax Court of Canada rendered its decision in *Torres v. The Queen. Torres* concerned a number of Taxpayers who had, innocently though negligently, fell victim to a business losses tax fraud known as Fiscal Arbitrators. In dismissing the Taxpayers' appeals, the Court viscerally concluded:[10]

> *[77] It is difficult to feel a great deal of sympathy for the Appellants notwithstanding some presented as most sympathetic characters, simply duped by the bad guys. Yet, underlying this purported duping is a motivation attributable to all of them to not have to pay taxes. Fiscal Arbitrators was not hired just to prepare their returns – it was hired to prepare their returns in such a way as to produce a significant refund; in fact, a refund that would result in no tax in the year in question, and with respect to some, prior years as well. I question how an individual, regardless of the level of education, who has worked in Canada, paid taxes and benefited from all the country has to offer, can without question enter an arrangement where he or she claims fictitious business losses and therefore simply does not have to pay his or her fair share, indeed, does not have to pay any share of what it takes to make the country function. I am not unsympathetic to spouses and family who may suffer from the significant negative financial consequences these penalties will heap upon them by the actions of the Appellants: the Appellants' penalties are indeed harsh. I however cannot pretend the specific 50% penalty called for by subsection 163(2) of the Act can be something less. That is only something the Government can consider.*
>
> *[78] It was clear to me these Appellants have paid a huge price, not just economically, as a result of Fiscal Arbitrators' deceitful ways. I have concluded, however, that penalties are clearly justified, though I am concerned about the devastating effect the magnitude of the penalties will have on the Appellants.*

Notwithstanding that *Torres* concerned a more characteristic type of tax fraud, and lacked any of the SR&ED-style R&D infrastructure present in the PIR tax fraud, the CRA analogizes one to the other in applying and justifying penalties under s.163(2). Beyond the weak and oversimplified analogy, use of *Torres* in a case such as PIR contradicts thirty years of established precedent and jurisprudence and effectively widens the ambit of s.163(2) to capture a class of taxpayers not intended by Parliament. As *Torres* and the jurisprudence show, the imposition of gross negligence penalties can have devastating effects and it is imperative that such extraordinary measures only be imposed where the evidence clearly demonstrates a "high degree of negligence, tantamount to intentional acting."[11]

---

[10] *Torres v. The Queen*, 2013 TCC 380 at paras 77-78

[11] *Venne v. R.*., [1984] C.T.C. 223 at 234 (FCTD)

Conclusion

PIR is no anomaly. Unfortunately, it serves to highlight a growing and troubling trend in Canada. This trend only serves to divert millions in tax revenue, erode the Canadian tax base and reduce faith in the administration of the Canadian taxation system.

Over the past years, CRA and the Government of Canada have made laudable, concerted and coordinated efforts to increase information sharing between taxpayers and the CRA and, in the words of Minister Findlay, to "rais[e] awareness of fraudulent schemes to protect Canadians from falling victim to unscrupulous promoters."[12] The Government and the CRA have also taken numerous steps to ensure that the perpetrators of these schemes face significant penalties. However, this is not enough. More must be done to protect another category of stakeholders: those who have, without intent or malice, fallen victim to these 'unscrupulous promoters' and as a result, have attracted significant penalties. In this regard, the Taxpayer Ombudsman recently reported that:

> "*more could and should be done to alert the public to the specific types of [tax shelter] schemes being promoted in Canada […] and how to recognize them. We also believe that much could be done to enhance the CRA's communication efforts on this subject.*"[13]

Given all of the above, we respectfully request that the Standing Committee on Finance give due regard and attention in preparing the 2015 federal budget to addressing tax fraud. Further, we would be honoured to provide more information and feedback on tax fraud and how it can be addressed through the 2015 federal budget, should the Standing Committee on Finance feel our attendance would be beneficial.

All of which is respectfully submitted.

Yours very truly,

DEVRY SMITH FRANK *LLP*

Eldad Gerb Ira Marcovitch, J.D. Candidate

[12] http://news.gc.ca/web/article-en.do?nid=828309

[13] Office of the Taxpayers' Ombudsman, *Donor Beware: Investigation into the Sufficiency of the Canada Revenue Agency's Warnings About Questionable Tax Shelter Schemes* (Ottawa: Office of the Taxpayers' Ombudsman, 2013) at 38.