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PENALTIES FOR TAX EVASION

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on Tax Evasion under the Income Tax Act (Canada) and the possible challenges to such assessments. Alpert Law Firm is experienced in providing legal services to its clients in tax dispute resolution and tax litigation, tax and estate planning matters, corporate-commercial transactions and estate administration. Howard Alpert has been certified by the Law Society as a Specialist in Estates and Trusts Law, and also as a Specialist in Corporate and Commercial Law.

A. SUBSECTION 239(1) PENALTIES

Tax evasion involves an illegal breach of specific statutory duties such as deliberately concealing or falsifying reported information. Pursuant to subsection 239(1) of the Income Tax Act (the "Act"), certain penalties may be levied against a person who is found guilty of tax evasion. Subsection 239(1) of the Act states that upon *summary* conviction for tax evasion, fines ranging from 50% to 200% of the amount sought to be evaded could be levied, as well as a possible imprisonment term of not more than two years.

Section 327 of the Excise Tax Act provides for similar penalties for HST evasion. However, there is a significant difference between the limitation periods of summary income tax offences and summary HST offences. Pursuant to subsection 786(2) of the Criminal Code, summary conviction offences, which includes summary Income Tax offences, have a limitation period of six months, such that no proceedings shall be instituted more than six months after the time when the subject-matter of the proceedings arose. Interestingly, subsection 332(4) of the Excise Tax Act, allows for a significantly longer limitation period of eight years for HST related summary conviction offences. In other words, a complaint relating to HST summary convictions may be laid or made on or before the day that is eight years after the day the matter of the information or complaint arose.

Note, that pursuant to subsection 239(2) of the Act, the Crown, which is usually represented by the Federal Department of Justice, also has the option of prosecuting, a person charged with evasion of taxes, by *indictment*. If convicted by indictment, fines ranging from 100% to 200% of the amount sought to be evaded could be imposed, as well as a maximum imprisonment term of five-years.

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Pursuant to subsection 239(1) of the Act, fines or a term of imprisonment may be imposed if it is proven beyond a reasonable doubt that a person has *intentionally* performed, or conspired to perform, any of the following activities:

(a) made, or participated in, assented, or acquiesced to the making of a false or deceptive statement in a tax return, certificate, statement or answer filed or made in respect to a taxation year;

(b) evaded the payment of tax by destroying altering, mutilating, hiding or otherwise disposing of a record or book of accounts;

(c) made, or participated in, assented, or acquiesced to the making of a false return or deceptive statement in a record or book of accounts; or

(d) wilfully, in any manner evaded or attempted to evade compliance with the Act or payment of taxes imposed by the Act.

As such, a finding of wilful tax evasion requires that deliberate intention (*mens rea*) on the part of the accused must be proven by the Crown.

The Courts have clearly established that an individual can only be convicted for an offence under one of the subparagraphs in subsection 239(1) of the Act, because to punish a taxpayer for an offence, under more than *one* of the subparagraphs, would have the effect of unduly punishing the taxpayer twice for the same crime. This rule reiterates the general principle that individuals should not be put in jeopardy more than once for the same offence.

In addition to imposing fines and/or a term of imprisonment under subsection 239(1) of the Act, it is also possible that the Minister of National Revenue (the "Minister") could impose civil penalties under section 163 and 162 of the Act. However, a person who is criminally convicted under subsection 239(1) of the Act cannot be held liable to pay a penalty imposed under sections 162 or 163 of the Act for the same evasion, unless that person was assessed for that penalty under section 162 or 163 before the information, or complaint giving rise to the criminal conviction, was laid or made.

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B. ACTIVITIES WHICH CONSTITUTE TAX EVASION

The Courts have found that a variety of activities meet the requirements of tax evasion. Case law has indicated that an individual may be successfully prosecuted for the crime of tax evasion if he or she knowingly makes, acquiesces or is wilfully blind to omissions or false statements, including the falsifying of documents, inflating invoices, overstating losses, and understating sales.

Case law has also demonstrated that individuals who are charged with tax evasion are more likely to be found guilty if any of the following factors are present:

(i) the accused possessed a high degree of general business knowledge or experience in the preparation of taxes;

(ii) the amount of understatement of income was so high that it could not be easily overlooked by any taxpayer;

(iii) there was a large number of errors or omissions; or

(iv) there was a pattern of understating income (i.e. the errors spanned a number of taxation periods); and

(v) the amount of understatement of income increased over the course of several taxation years.

In order for the Crown to prove an offence under the Act, there are often two elements each of which must be proved beyond a reasonable doubt: (i) *actus reus* and (ii) *mens rea*. *Actus reus* is the guilty, wrongful or prohibited act or omission. *Mens rea* refers to a “guilty mind”, that is, the knowledge that the act committed is wrongful or prohibited, or that the person intended to commit the prohibited act. The *mens rea* for tax evasion, for example, may be satisfied by proof that the taxpayer intentionally made statements knowing they were false.

The Courts have consistently distinguished between the tax planner and the tax evader. The former intends to avoid owing tax under the Act, whereas the latter intends to avoid the payment of tax that is owed under the Act. The Courts have restated that it is perfectly legitimate for a person to structure his affairs to minimize tax liability. Recent case law has also noted that in certain circumstances, mistake or ignorance regarding tax liability may negate the *mens rea* requirement.

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C. NET WORTH ASSESSMENT

Pursuant to the provisions of subsection 152(7) of the Act, the Minister may use a net worth assessment (also known as an arbitrary assessment) as a method of estimating an individual's annual income where (i) no tax return has been filed; (ii) the Minister considers that the tax return which has been filed is inaccurate; or (iii) the taxpayer has not maintained adequate records of the taxpayer's income.

Even if the Minister cannot prove the exact amount of tax owing based upon a net worth assessment, a taxpayer may still be found guilty of tax evasion if it can be proved beyond a reasonable doubt that the taxpayer wilfully evaded or attempted to evade compliance with the Act or payment of taxes imposed by the Act.

D. IMPACT ON TAX-PREPARING PROFESSIONALS

While subsection 239(1) of the Act is usually used to convict taxpayers who wilfully perform any of the above activities, any persons who are intentionally involved in the making of an erroneous tax return can also be subject to punishment under this subsection. As case law has indicated, tax preparing professionals, such as accountants, can be charged under this subsection.

Specifically, accountants have been found guilty of tax evasion on the basis that given their high degree of tax knowledge, at the very least, they must have been wilfully blind to the error. However, case law has indicated that accountants have successfully defended against charges of tax evasion on the grounds that they were duty bound by professional standards to act as they did.

E. APPLICATION TO THE VOLUNTARY DISCLOSURES PROGRAM

Pursuant to subsection 220(3.1) of the Act, the Canada Revenue Agency has wide discretion to give equitable relief to taxpayers by cancelling or waiving penalties and interest that would otherwise be payable under the Act. This discretion is exercised partly through the Voluntary Disclosures Program. If a voluntary disclosure is found to satisfy all the requisite conditions, relief will be provided from penalties and prosecution that may otherwise have been imposed.

For income tax submissions made on or after January 1, 2005, the Minister cannot grant relief to any taxation year beyond 10 years from the calendar year in which

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the submission was filed. This 10 year limitation period for relief rolls forward every January 1. An exception to this 10 year limitation period applies where the initial submission to the Minister was made prior to January 1, 2005, when the 10 year limitation rule came into effect. Unless an initial request for relief was filed by the taxpayer before January 1, 2005, the Minister will not accept submissions for the 1985 to 1994 taxation years.

Despite the foregoing limitation period for tax relief from penalties and prosecution, there is currently no limitation period on the ability of the Minister to examine unreported income kept in offshore accounts. The Minister can assess back taxes and interest for an infinite number of years while only offering relief for the most recent 10 years.

In June 2010, there were indications that the CRA was working towards a more lenient and consistent approach for the repatriation of offshore income taxes. In order to encourage voluntary disclosures, under the new CRA rules, where voluntary disclosures are made, auditors would only go back a maximum of 10 years when assessing offshore unreported income and it would be unnecessary for the taxpayer to explain the initial capital.

F. FACTORS IN SENTENCING AN OFFENDER

Upon finding a person guilty of tax evasion, either summarily or by indictment, the Court will decide upon the amount of fines and/or the term of imprisonment to be levied. Courts impose such fines and imprisonment terms according to the particular facts of each case.

In general, case law has indicated that, when deciding on the appropriate sentence to impose, Courts consider factors such as:

(i) the gravity of the offence (i.e. the amount involved in the evasion);

(ii) the degree of deliberation shown by the offender;

(iii) the offender's age and character; and

(iv) deterrence to the taxpayer and to other taxpayers.

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This issue of the Legal Business Report is designed to provide information of a general nature only and is not intended to provide professional legal advice. The information contained in this Legal Business Report should not be acted upon without the further consultation with professional advisers.

Please contact Howard Alpert directly at (416) 923-0809 if you require assistance with tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions or estate administration.

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