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May 31, 2023

The Honourable Chrystia A. Freeland, P.C., M.P.
Deputy Prime Minister and Minister of Finance
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5
Canada

Via email: GAAR-RGAE@fin.gc.ca

RE: Proposed GAAR Penalty

Dear Minister Freeland:

This letter addresses the proposed addition of a penalty provision (the "**Proposed Penalty**") to the General Anti-Avoidance Rule (the "**GAAR**") under section 245 of the *Income Tax Act* (Canada) (the "**Act**")[1] as part of a package of proposed amendments to the GAAR in Budget 2023 (the "**Budget Proposal**").[2] The Canadian government (the "Government") requested input on the Proposed Penalty from interested stakeholders no later than May 31, 2023. On behalf of Tax Executives Institute, Inc. ("**TEI**"), I am pleased to respond to the Government's request.

About TEI

TEI was founded in 1944 to serve the professional needs of in-house tax professionals. Today, the organization has 56 chapters across North and South America, Europe, and Asia, including four chapters in Canada. Our over 6,000 members represent 2,800 of the world's leading companies, many of which either are resident or do business in Canada. Over 15 percent of TEI's membership comprises tax professionals who work for Canadian businesses in a variety of industries across the country. TEI members are responsible for tax affairs of their employers and must contend daily with provisions of the tax law relating to the operation of business

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1 All statutory references, unless otherwise indicated, are to the provisions of the Act.

2 *Budget 2023 Tax Measures: Supplementary Information*: https://www.budget.canada.ca/2023/pdf/tm-mf-2023-en.pdf

enterprises. The following recommendations reflect the views of TEI as a whole but, more particularly, those of our Canadian constituency.

As the preeminent association of in-house tax professionals worldwide, TEI is dedicated to the development of sound tax policy, compliance with and uniform enforcement of tax laws, and minimization of administration and compliance costs to the mutual benefit of government and taxpayers. TEI is committed to fostering a tax system that works—one that is administrable and with which taxpayers can comply in a cost-efficient manner. The diversity, professional training, and global viewpoints of our members enable TEI to bring a balanced and practical perspective to the Proposed Penalty.

TEI Comments

This letter specifically addresses the Proposed Penalty included in the Budget Proposal's potential changes to the GAAR. While our members have concerns with certain other changes to the GAAR in the Budget Proposal, those concerns have been addressed by other stakeholders so need not be repeated here.[3]

In our view, the Proposed Penalty is inappropriate and unnecessary, considering other proposed amendments to the GAAR in the Budget Proposal. There is no evidence that the Act's existing provisions – which are, apparently, sufficient to address technical non-compliance with the Act – are insufficient to address the sorts of abusive tax planning contemplated by the Proposed Penalty. If, however, the Government implements the Proposed Penalty, it should be subject to similar fault requirements to those required for other penalties under the Act. This would mean taxpayers are only liable for penalties in respect of a GAAR reassessment where a meaningful fault requirement is satisfied, *i.e.*, where there has been gross negligence or willful blindness. Further, any GAAR penalty should be coupled with substantive changes to the Canada Revenue Agency's ("**CRA**") assessing practice in respect of the GAAR to ensure that taxpayers are safeguarded from inappropriate usage of such penalties.

The remainder of this letter discusses (i) why a distinct GAAR penalty is unnecessary; (ii) why any GAAR penalty should be subject to a significant fault requirement; and (iii) necessary changes to CRA administrative practices that should accompany the enactment of a GAAR penalty.

I. A Distinct GAAR Penalty is Unnecessary

We understand that the policy rationale underpinning the Proposed Penalty, at least as described in the Government's consultation paper *Modernizing and Strengthening the General Anti-Avoidance Rule*[4] (the "**Consultation Paper**") is a concern that, absent a penalty, "the economic downside to taxpayers [of

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[3] E.g., the submissions of the Canadian Chamber of Commerce (https://chamber.ca/canadian-chamber-shares-post-budget-comments-on-the-general-anti-avoidance-rule-gaar/) (the "**CCC Submission**").

[4] https://www.canada.ca/en/department-finance/programs/consultations/2022/general-anti-avoidance-rule-consultation/modernizing-strengthening-general-anti-avoidance-rule.html

engaging in abusive tax planning] may be limited to the professional fees incurred for implementing the transactions plus the non-deductible interest on the taxes owing. In contrast, the upside can be significant."[5] In other words, the concern is that taxpayers may be motivated to engage in abusive tax planning – *e.g.*, tax planning that, if challenged under the GAAR, is unlikely to succeed – by taking the chance that the CRA does not detect the transaction.[6] In our view this concern is unfounded and, in any event, fully addressed by other changes to the Act.

The Government's view of the economic downsides to taxpayers of a GAAR reassessment grossly understates the economic costs of the reassessment. The professional fees associated with contesting a GAAR reassessment are considerable and, typically, only partially compensated for when taxpayers successfully challenge such reassessments. Thus, taxpayers facing a GAAR dispute know that, even if they win, they will incur significant professional fees. If unsuccessful, of course, not only must they bear their own costs, but must also reimburse the Crown for its costs (or, at least, a portion thereof).

Similarly, the view that taxpayers "only" face non-deductible interest on taxes owed does not appear to acknowledge that such interest is calculated at a rate four percentage points higher than the rate payable by CRA on amounts it owes to taxpayers (and significantly higher than the – fully taxable – risk free rate that taxpayers can earn on the value of their tax benefit). The punitive interest rate (currently 9% per annum), coupled with the lengthy delays associated with contesting GAAR reassessments – GAAR disputes are routinely resolved more than ten years after the year in which the dispute arises – means that, in the event a GAAR challenge is successful, some taxpayers will owe more in interest than taxes.[7] Relatedly, the Budget Proposal to extend the reassessment period for GAAR reassessments by three years,[8] which gives the CRA more time to identify and reassess transactions subject to the GAAR, will only increase the interest cost associated with successful GAAR reassessments. The implication that such costs are insignificant is ill-founded.

The Government also fails to account for other costs faced by taxpayers in contesting GAAR disputes. Taxpayers, and their officers and employees, devote considerable time and effort to contest such disputes – responding to audit queries, collecting relevant documentation (both for audit and discovery), assisting their professional advisors, and attending depositions. For individual taxpayers, this requires taking time away from their work, business, or family to perform such tasks. For businesses, this requires devoting productive resources to such tasks. Furthermore, for large corporations, the

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5 Consultation Paper, p.32.

6 Unexplained is how the CRA is aware of all the alleged avoidance transactions it has, apparently, failed to detect.

7 Taxpayers can, of course, mitigate this interest expense by paying all or a portion the disputed tax either voluntarily or, in the case of large corporations, by statute. Doing so, however, imposes a significant opportunity cost by tying up valuable capital.

8 Budget Proposal at p.38.

requirement to post 50% of the amount of tax in dispute (or other acceptable security) imposes an additional significant cost.

Taxpayers may, of course, take positions contrary to those taken by the CRA. Taxpayers who engage in transactions that are successfully challenged under the technical provisions of the Act are not generally subject to penalties in the absence of gross negligence or willful blindness (i.e., a gross negligence standard). Since Parliament has determined that the imposition of penalties in the absence of gross negligence or willful blindness is generally unnecessary to promote compliance with the Act as a whole,[9] it is unclear why further penalties are necessary for taxpayers who are reassessed under the GAAR, or why the existing penalty provisions contained in the Act are inadequate to deter such behaviour.[10]

Finally, insofar as the rationale for a GAAR penalty is to offset the (allegedly) low probability of the CRA detecting abusive transactions, this concern is fully addressed by the proposed extension of the normal reassessment period for GAAR assessments coupled with the current expansion of the "reportable transaction" rules and the enactment of the "notifiable transaction" rules (collectively, the "**Mandatory Reporting Rules**") whose rationale is precisely to help CRA identify such transactions. Those changes are intended to both identify abusive tax planning early in the audit cycle and provide the CRA with significantly more time to reassess taxpayers who engage in such planning. To assert that a GAAR penalty is necessary to discourage what some may consider to be aggressive tax planning is to anticipate that those changes will not be effective in achieving their objective. At the very least, the Department of Finance ("**Finance**") should wait to see if those changes have the desired effect before implementing a GAAR penalty.

II. Any GAAR Penalty Should be Subject to a Significant Fault Requirement

If, notwithstanding the foregoing, the Government proceeds with a distinct GAAR penalty, any such penalty should contain a significant fault requirement, such as gross negligence, consistent with penalties for technical non-compliance with the Act – it should not apply simply because the CRA reassesses the taxpayer under the GAAR. At present, the Proposed Penalty does not identify the relevant fault requirement for the imposition of a GAAR penalty. In addition, the Budget Proposal suggests that

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[9] *See*, *e.g.*, subsection 163(2).

[10] We are unaware of any reported case where CRA has sought to apply penalties under subsection 163(2) to a GAAR assessment, suggesting that the sort of egregious behaviour motivating the Proposed Penalty has not, heretofore, been commonplace. Certainly, this undermines the claim in the Discussion Paper that the Courts have shown a "reticence" to impose such penalties, particularly given that that claim refers to a single case where the Courts refused to impose penalties for failing to withhold on a person who was not the taxpayer who realized the impugned tax benefit.

the Proposed Penalty can only be avoided if the transaction is disclosed to the CRA, suggesting that taxpayers could be subject to penalties without a meaningful fault requirement.[11]

In the 1988 Technical Notes that accompanied the original enactment of GAAR, it was stated that the new GAAR seeks to "establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs." We assume that this is still the purpose of the GAAR. However, the proposed automatic penalty with no fault requirement tips the scales so far in CRA's favour that "balance" is nowhere to be found.

Most TEI members are employed by public companies who must produce audited financial statements for public disclosure and would not be able to engage in transactions where they expect the GAAR to apply. Our membership is also generally subject to audit by the CRA for each taxation year pursuant to the CRA's large file case program. Simply put, the policy rationale for this proposed change is inapplicable to most of TEI's members. Further, we believe that our members are not unique among Canadian taxpayers' writ large. Any penalty provision targeted at taxpayers who take chances regarding detection on audit must distinguish between these taxpayers and those who genuinely believe that their activities are not subject to the GAAR. The need for a fault requirement to be met before imposing the Proposed Penalty reflects a number of principled and practical considerations.

a. A fault requirement for penalties is a principal of fundamental justice and consistent with the policy of the Act

It is a tenet of the common law and a principle of fundamental justice that there "should be no punishment without fault".[12] The imposition of a GAAR penalty without a fault requirement would violate this principle.

In his seminal decision, *Pillar Oilfield Projects Ltd. v. The Queen*[13], Justice Bowman (as he then was) held that it would be contrary to the principles of "fundamental justice" and "fairness" to withhold the right to plead due diligence regarding penalties imposed by a taxing statute:

> That a person should be susceptible of being penalized administratively by a public servant without any possibility of exculpating himself by demonstrating due diligence is not only extraordinary. It is abhorrent. It is no less abhorrent because it is mechanically and routinely imposed by anonymous revenue officials and therefore qualifies for the essentially meaningless rubric "administrative" rather than "criminal". A punishment is

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11 At p.39.

12 *A.G. (Canada) v Consolidated Canadian Contractors Inc.*, [1999] 1 F.C. 209 (FCA) ("***Canadian Contractors***") at para 17. See also *R. v. Sault Ste. Marie*, [1978] 2 SCR 1299, ("***Sault Ste. Marie***") at page 1326: "[T]he principle that punishment should in general not be inflicted on those without fault…"

13 [1993] 2 G.S.T.C. 1005 (T.C.C.).

> a punishment. Neither its nature nor its effect is tempered by the use of palliative modifiers.

This principle was subsequently substantively affirmed by the Federal Court of Appeal (the "**FCA**") in *Canadian Contractors*. While the FCA recognized that Parliament could seek to impose "absolute liability on the understanding that its benefits outweighed any unfairness", it concluded that:

> The principle that there is to be no punishment without fault translates into a rebuttable presumption that Parliament did not "intend" to impose absolute liability. This presumption is also a logical extension of the understanding that penalties serve as an incentive to ensure that persons exercise a minimum standard of care in fulfilling their obligations imposed by law. The idea is to encourage people to exercise reasonable care so they can avoid breaching their legal obligations. If so, then the person being penalized should be able to plead that he or she acted in accordance with the required standard of care.

Following the guidance of the FCA in *Canadian Contractors*, trial courts have consistently read a due diligence defense into other penalty provisions in the Act (and other taxing statutes) which are otherwise silent on the requisite fault requirement to ensure that taxpayers are not penalized in the absence of fault on their part.[14] While we would anticipate that, absent an express fault requirement, Canadian courts would extend that policy to any future GAAR penalty, an express fault requirement is essential to providing certainty on this point (we return to this point in our discussion of the protective disclosure proposal, below).

Finally, we note that this principle is also reflected in the existing general penalty provisions of the Act for taxpayers (subsection 163(2)) and advisors (section 163.2) which impose penalties only where a taxpayer or advisor makes a false statement (e.g., an inaccurate tax return) knowingly or in circumstances amounting to gross negligence. This principle is also reflected in other provisions of the Act which relieve persons of liability for penalties where they establish that they exercised due diligence (e.g., section 227.1(3) dealing with director liability for failing to withhold, section 233.5 with respect to certain foreign reporting requirements, section 237.3 dealing with "reportable transactions", and proposed new section 237.4 dealing with "notifiable transactions"). And, as noted above, the courts have routinely read a due diligence defense into penalty provisions of the Act which are otherwise silent on the point.

In that light, the imposition of a GAAR penalty without a significant fault requirement would depart from both principles of fundamental justice and the policy and jurisprudence in respect of the existing penalty provisions of the Act.

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[14] See, *inter alia*, with respect to penalties under the Act, *Douglas v. the Queen,* 2012 TCC 73, *Moore v. the Queen*, 2019 TCC 141, and with respect to penalties under the *Excise Tax Act*, *Home Depot of Canada Inc. v. The Queen*, 2009 TCC 281.

b. A penalty is inappropriate in the face of genuine uncertainty as to the application of the GAAR

The GAAR is a remedial provision, intended to apply in circumstances where taxpayers have technically complied with the technical provisions of the Act, interpreted in a textual, contextual, and purposive manner, but in circumstances which are inconsistent with the object, spirit, and purpose of such provisions. The GAAR is a provision of last resort that overrides the words of other provisions in the Act with which the taxpayer has technically complied. It is a backstop meant to protect the integrity of the tax system. It was not intended to be a punitive provision.

Most GAAR reassessments involve transactions where there is genuine disagreement between the Government and the taxpayer about the object, spirit, and purpose of the Act's provisions. We expect that this reality informs the CRA's prior practice of not seeking to impose penalties in respect of GAAR reassessments. As Justice Hogan noted on this very point in *Mady v. The Queen*:

> It is well known that the Minister rarely seeks to apply gross negligence penalties when transactions are considered to violate specific anti-avoidance provisions or the GAAR. Those types of provisions are by their nature difficult to interpret. Skilled tax advisors and the CRA have difficulty identifying where the boundaries of anti-avoidance provisions lie.[15]

In some cases, there may be disagreement among the courts, or even among judges at the same court, as to whether the GAAR should be applied as the GAAR analysis is complex.[16] In other instances, the CRA struggles with the proper interpretation of the GAAR (reflected in the fact that the CRA is only successful in roughly half of its contested GAAR cases). In such cases it would be profoundly unfair to penalize taxpayers for failing to correctly ascertain the answer to a genuinely complex and contestable question of fact and law.[17]

Furthermore, as the courts have consistently noted, where taxpayers have taken reasonable precautionary measures to comply with the Act – that is to say, where taxpayers have exercised due diligence – it is unreasonable to expect that the imposition of a penalty will change their behaviour – they

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15 2017 T.C.C. 112 (at para.146).

16 For example, in *Lipson et al. v. the Queen*, 2009 SCC 1, the Justices of the Supreme Court of Canada produced three separate and mutually incompatible interpretations of the application of the GAAR. *See also Univar Holdco Canada ULC v. The Queen*, 2017 FCA 207, rev'g 2016 TCC 159, where the taxpayer was unsuccessful at Tax Court but successful at the Federal Court of Appeal; *Oxford Properties Group Inc. v. The Queen*, 2018 FCA 30, *rev'g* 2016 TCC 204, where the taxpayer was successful at Tax Court but unsuccessful at the Federal Court of Appeal; and more recently *The Queen v. Alta Energy Luxembourg S.A.R.L.*, 2021 SCC 49, where the taxpayer was successful in a 6-3 decision from the Supreme Court of Canada.

17 We expect that the Government would think it quite unfair if the CRA were to be subject to sanctions merely for unsuccessfully reassessing taxpayers under GAAR, absent some further fault on the CRA's part (e.g., gross negligence, malicious prosecution). The same consideration should apply to taxpayers.

already reasonably believe that they are fulfilling their obligations. As the Supreme Court of Canada noted in *Sault Ste. Marie*:

> There is no evidence that a higher standard of care results from absolute liability. If a person is already taking every reasonable precautionary measure, is he likely to take additional measures, knowing that however much care he takes, it will not serve as a defence in the event of breach? If he has exercised care and skill, will conviction have a deterrent effect upon him or others? Will the injustice of conviction lead to cynicism and disrespect for the law, on his part and on the part of others?[18]

In addition, the CRA's view of the object, spirit, and purpose of a provision can change over time. There have been numerous instances where the CRA has adopted a new, and different, administrative approach to well-established transactions (or substantially similar transactions) and subsequently applied such new views retroactively to issue GAAR reassessments in respect of transactions implemented based on the prior CRA interpretation. This would also be an inappropriate situation in which to levy penalties on a taxpayer if the CRA were successful in challenging a transaction under the GAAR.

Further, the imposition of a GAAR penalty based on the amount of the "tax benefit" fails to reflect the remedial nature of the GAAR. Subsection 245(5) permits the Finance Minister to redetermine the tax consequences to a taxpayer in a manner that is reasonable under the circumstances. In some cases, however, a reassessment that is "reasonable in the circumstances" would not result in a complete disallowance of the benefit received by the taxpayer. For example, in *The Queen v. Oxford Properties*, the taxpayer was reassessed on the basis that it had realized a tax benefit of $148.1 million, but the Federal Court of Appeal ultimately decided that only $116.5 million of that benefit was attributable to an abuse of the Act.[19] It is unclear how the Proposed Penalty would apply in circumstances such as these where the GAAR applies but not in respect of the full amount of the tax benefit. In our view, it is clearly inappropriate to impose a penalty on the portion of a tax benefit a court determines is not abusive. While a fault requirement doesn't fully address the unfairness of this potential result, in practice it may substantially mitigate it.

This is not to say that a penalty in respect of GAAR reassessments is inappropriate in all circumstances, but it does suggest that the imposition of a penalty should require something more than the mere application of the GAAR, *i.e.*, a fault element. For example, while the mere application of the GAAR should not trigger a GAAR penalty, a taxpayer who engages in transactions that are the same or substantially similar to transactions which have been previously determined by the Courts to be subject to the GAAR are arguably grossly negligent or wilfully blind to their liability for tax under the GAAR,

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18 Sault Ste. Marie at p. 1311. See also, *inter alia*, *Canadian Contractors* at para. 16.

19 2018 F.C.A. 30.

such that a penalty may be appropriate. However, this is not what is currently contemplated under the Proposed Penalty.

c. *A GAAR Penalty without a significant fault requirement could produce perverse and unfair results*

The Act currently provides for penalties for incorrect tax reporting, but only in circumstances where the incorrect reporting arose from gross negligence or wilful blindness. However, by definition the GAAR only applies where taxpayers have complied with the technical provisions of the Act, interpreted in a textual, contextual, and purposive manner. Absent a fault requirement, it would be counterintuitive – and profoundly unfair – that a taxpayer whose incorrect tax reporting arises from non-compliance with the text of the Act would not be subject to penalties, absent gross negligence or wilful blindness, while a taxpayer who has complied with the text of the Act, but found to be subject to the GAAR, would be subject to penalties.

Indeed, given that the CRA often relies upon the GAAR as a secondary assessing position, this raises the absurd possibility that a taxpayer will be liable for a penalty in respect of a particular transaction only if they complied with the text of the Act (such that the GAAR applies) – that is to say a taxpayer would be better off to be found by a Court to have failed to comply with the text of the Act than to be found to have complied with the Act in a manner that is subject to the GAAR. Such a result would be perverse.[20]

d. Protective Disclosure and the Fault Requirement

We note that the Budget Proposal would permit taxpayers to avoid the imposition of the Proposed Penalty by making protective disclosure to the CRA (the "**Protective Disclosure Proposal**"). However, the Protective Disclosure Proposal does not adequately address the above concerns. Indeed, it suffers from two significant defects.

First, in practice, while the ability to make protective disclosure may provide comfort for taxpayers who knowingly engage in "marginal" transactions where they believe there is a significant risk of the GAAR applying, this is of little comfort to taxpayers who consciously seek to avoid effecting transactions with a significant risk of the GAAR applying, but who may nevertheless be reassessed under the GAAR. For example, taxpayers who are public corporations typically proceed based on "should" level advice (e.g., that the GAAR "should not" apply to their transactions). While such taxpayers have reasonable grounds for believing that the GAAR does not apply to them, the CRA could dispute that belief. The Protective Disclosure Proposal presents taxpayers with the difficult choice between disclosing every transaction they engage in to the CRA – which for some taxpayers may be a logistical impossibility – or risk being subject to significant GAAR penalties if their assessment of the non-applicability of the GAAR is subsequently determined to be incorrect.

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[20] We note that the Consultation Paper acknowledges, at page 34, this perverse result but the Proposed Penalty does nothing to mitigate it.

This concern is aggravated by another proposed amendment to the GAAR contained in the Budget Proposal whereby the threshold for an "avoidance transaction" is changed from a "primary purpose" test to a "one of the main purposes" test.[21] Whereas previously, taxpayers could take comfort that the GAAR would not apply where achieving a tax benefit was not the primary purpose of the transaction, the effect of lowering the threshold for the application of the GAAR is to increase the universe of transactions potentially subject to the GAAR. Simultaneously expanding the scope of transactions that may be subject to the GAAR while expecting taxpayers to report all such transactions to avoid the imposition of penalties is simply untenable.

Predictably, absent a robust fault requirement, taxpayers who engage in higher-risk transactions will make protective disclosures and will avoid the imposition of penalties, while taxpayers who engage in what they reasonably consider to be "low risk" transactions will not make preventative disclosure and will potentially be subject to penalties. This would be a perverse result. Subjecting the Proposed Penalty to a fault requirement addresses this concern by relieving taxpayers who, on reasonable grounds, fail to make protective disclosures, while still promoting disclosure by taxpayers who engage in higher-risk transactions.

Second, we are concerned that the existence of a protective disclosure regime, absent an express due diligence defense, could potentially be interpreted as precluding the availability of the common law due diligence defense (discussed above) generally available in respect of penalties under the Act by suggesting a Parliamentary intent to dislodge the presumption of strict liability. As noted above, while penalties are presumed to give rise to strict liability, subject to a due diligence defense, if the broader legislative context surrounding the provision suggests otherwise, that presumption can be rebutted. If the availability of a protective disclosure provision were interpreted as suggesting that the "fault" element of the GAAR penalty is the failure to disclose, it could refute the presumption of strict liability. While our view is that such an interpretation would be inappropriate – for the reasons set out above – in the absence of an explicit fault requirement in the GAAR provision there is a concern that such an interpretation could preclude a taxpayer from avoiding the Proposed Penalty in the absence of a protective disclosure.

e. Consistency with Mandatory Reporting Rules

As noted above, the enactment of the Mandatory Disclosure Rules coupled with the proposed expansion of the limitation period for GAAR reassessments, will allow the CRA to identify and audit "aggressive" tax planning. While reporting is mandatory under the Mandatory Reporting Rules and non-compliance is subject to a significant penalty, they provide a due diligence defense for non-reporting. Again, it would be perverse if a duly diligent taxpayer could be subject to a penalty for, essentially, failing to make a voluntary disclosure under the GAAR, but not for making a mandatory

[21] *See* the Budget Proposal, p.38.

disclosure under the Mandatory Reporting Rules. There should be consistency between the Protective Disclosure Proposal and the Mandatory Reporting Rules.

f. Potential unintended or undesirable consequences of imposing a GAAR penalty

Finally, we encourage Finance to consider the potentially unintended or undesirable consequences of imposing a GAAR penalty without a fault requirement.

First, it raises the concern that GAAR reassessments could have the effect of coercing taxpayers to settle otherwise meritorious cases. As discussed above, many GAAR disputes involve transactions where there is genuine uncertainty between the government and the taxpayer about the object, spirit, and purpose of the Act's provisions. Furthermore, as also discussed above, taxpayers already face a significant cost in contesting bona fide tax disputes (e.g., punitive interest, professional fees, time and effort, etc.). Adding the potential imposition of a penalty will, absent a robust fault requirement, have the effect, at the margin, of inducing risk-averse taxpayers to settle cases (perhaps on a technical basis to avoid the imposition of a penalty) which, on the merits, they would win. We understand that the government acknowledges this concern – the Consultation Paper describes this aspect of the Proposed Penalty as a feature, rather than an offensive bug.[22] It is wholly inappropriate for the Government to use the threat of penalties as a cudgel to force taxpayers to abandon otherwise meritorious claims. Indeed, the unfairness of using a penalty to induce settlement is likely to result in the sort of "cynicism and disrespect for the law" among taxpayers which undermines the integrity of the tax system that the Supreme Court of Canada warned about in *Sault Ste. Marie*. Imposing a fault requirement for a GAAR Penalty ensures that taxpayers who have meritorious cases can vigorously contest such cases without fear of sanctions if they are unsuccessful and reinforces public confidence in the fairness of the tax system.

Second, a GAAR penalty in the absence of a meaningful fault requirement may distort judicial analysis of GAAR cases. Judges are human and are influenced by concerns for justice and fairness. Absent a robust fault requirement, the imposition of a GAAR penalty in the event of successful reassessment may affect judicial interpretations of the GAAR or discourage judges from finding that the GAAR applies in "edge" cases – circumstances where the GAAR should, from a policy perspective, apply, but where it would be inequitable to subject the particular taxpayer to a penalty – as the saying goes, "bad facts make for bad law".[23] Finance should not assume that that GAAR jurisprudence that

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[22] At page 35 of the Consultation Paper, the Government notes that in the case of a penalty similar to the Proposed Penalty "taxpayers would have an incentive to settle on the basis of the primary technical position, if the primary position does not come with a penalty, and the CRA would presumably have the discretion to accept that approach." Curiously undiscussed is why it is a good thing for taxpayers to settle disputes on basis that they believe is incorrect to avoid a penalty.

[23] It's worth noting that the Consultation Paper, at page 34, acknowledges that a penalty which is seen as "too high" could result in a reluctance to apply the GAAR, and cites prior examples of similar results. That the same results could arise from a penalty that is seen as "unfair" by the judiciary is hardly a stretch.

evolved when the GAAR was a strictly remedial provision will not change if it becomes a punitive provision.

Third, the penalty as drafted conflicts with the stated goal of certainty, predictability, and fairness. In the consultation paper released in 2022, the Department of Finance made repeated reference to the need for the tax system to be grounded in "certainty, predictability and fairness". The imposition of an automatic penalty with no defense for taxpayers flies directly in the face of these principles.

Consider that the proposed preamble states that the GAAR can apply regardless of whether a tax benefit is foreseen. Automatically applying a penalty to a tax benefit that a taxpayer never sought to obtain in the first place creates massive uncertainty and unpredictability. It is also patently unfair to every compliant taxpayer not intentionally engaged in abusive tax avoidance. Moreover, the ability to voluntarily report an unforeseen tax benefit in an attempt to protect against penalties is, quite obviously, impossible. Should the government proceed with a GAAR penalty, this example speaks clearly to the need for a fault requirement.

Finally, by increasing the stakes of a GAAR reassessment, the proposed penalty will likely increase the cost, complexity and length of GAAR litigation – it adds another significant issue to be resolved between the parties. Apart from simply increasing the cost of such disputes and increasing the burden on an already overstretched tax court, it may increase the amount of taxpayer costs that Courts are willing to award to successful GAAR appeals. Under section 147 of the *Tax Court of Canada Rules of General Procedure*, a Tax Court Judge exercising his or her discretion to award costs over and above those set out in the Tariff may consider a variety of factors potentially affected by the imposition of a GAAR penalty, including (i) the amounts in issue and (ii) the importance of the issues. Adding a GAAR penalty places greater emphasis on those points and granting increased costs in successful appeals of GAAR reassessments might be seen by the Courts as an appropriate means to address the power imbalance between taxpayers and the Crown.

III. CRA Administrative Practice

The imposition of a GAAR penalty – indeed, any changes to the GAAR – should be accompanied by significant changes to the CRA's administrative practices vis-à-vis GAAR reassessments. As others have noted, the analysis of the GAAR committee would benefit greatly from receiving *viva-voce* representations from taxpayers (or their representatives).[24] This would be true even in the absence of a GAAR penalty but becomes significantly more important in light of the increased stakes arising from the imposition of a GAAR penalty. If the Government intends to penalize taxpayers, it should ensure that the process for imposing such penalties include more safeguards and provides taxpayers with an opportunity to put their best foot forward to the GAAR committee.

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[24] *See*, *e.g.*, the CCC Submission at page 61.

Similarly, the imposition of any penalty should be determined by a committee (or perhaps the GAAR committee) rather than by specific audit teams, to ensure that penalties are only imposed in appropriate circumstances and in a consistent and uniform manner. We understand that CRA is proposing to adopt such a practice with respect to penalties under the Mandatory Reporting Rules and would encourage the CRA to adopt a similar practice with respect to any GAAR penalties. Again, such a committee should seek viva voce representations from taxpayers (or their representatives).

Conclusion

TEI appreciates that the proposed changes to the GAAR are complex and nuanced. We would be pleased to discuss our concerns with the Department and request the opportunity to consult on further changes as they develop, whether by an in-person or virtual discussion. We look forward to hearing from the Department as this critically important piece of legislation progresses.

TEI's comments were prepared under the aegis of its Canadian Income Tax Committee, whose Chair is Steve Saunders of Atco. Should you have any questions about the Institute's comments, please do not hesitate to contact Mr. Saunders at Steve.Saunders@atco.com or Benjamin R. Shreck of TEI's Legal Staff at bshreck@tei.org or 202.464.8353.

Respectfully submitted,

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