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Should Taxpayers Be Penalized for Their Accountant's¹ Lack of Due Diligence: A Criminal Lawyer and a Tax Lawyer Both Say No! Part I²

David H. Sohmer and Suzanne Costom

Paragraph 35 of Information Circular 07-1, Taxpayer Relief Provisions, states that "[t]axpayers are generally considered to be responsible for errors made by third parties acting on their behalf for income tax matters".

The position of the CRA is a reasonable reflection of the tax jurisprudence. In the case of *Roberts v. R.*,³ Justice Bowman stated:

The accountants are after all the appellant's agents and the appellant is responsible of what they did or failed to

do. In the same way as the exercise of due diligence on the part of the taxpayer's accountants or bookkeepers would be attributed to the taxpayer and would justify the removal of a penalty, so too that the absence of due diligence on the part of the taxpayer's accountants or bookkeepers disentitle him or her to the relief envisaged by the *Pillar Oilfield* case.

In the case of *Stemijon Investments Ltd. v. Canada (Attorney General)*,⁴ the Federal Court of Appeal went as far as characterizing the engagement of a professional tax return preparer as the conscious acceptance of the risk that the preparer may not exercise due diligence:

Each of the appellants is a separate legal entity and a separate taxpayer, potentially subject to penalties and interest for its own non-compliance. Each is capable of independent decision-making concerning the forms that are to be filed. Each, accepting the risk, chose instead to have a representative look after the filings. That risk materialized: their representatives made a conscious decision not to file the forms, a decision made without reasonable excuse or justification, as explained above.

¹ The term "accountant" loosely refers to third party tax return preparers.

² Part II will be in the next issue of *The Canadian Taxpayer*.

³ 1997 CarswellNat 1131, (sub nom. *Roberts v. Canada*) [1997] G.S.T.C. 58, 5 G.T.C. 1146, [1997] T.C.J. No. 771, at para. 9.

⁴ 2011 CarswellNat 4372, 2011 FCA 299, [2012] 1 C.T.C. 207, 2011 D.T.C. 5169 (Eng.), 341 D.L.R. (4th) 710, 425 N.R. 341, at para. 51.

IN THIS ISSUE

Should Taxpayers Be Penalized for Their Accountant's Lack of Due Diligence: A Criminal Lawyer and a Tax Lawyer Both Say No! Part I	105
Trench Warfare over C-38	108
Consultation for 2013 Budget Under Way	109

Offshore Trust Planning	109
Trans-Pacific Partnership Membership: At What Cost?	111
Letter from Sherman Re Tax Court Administration . .	112



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Granting relief under subsection 220(3.1) on the basis of this argument would be an unreasonable exercise of discretion.

The position that taxpayers may be penalized for the lack of due diligence of their representatives appears to have been imported from the doctrine of vicarious liability in tort law which imposes liability upon an employer or principal for the conduct of an employee or agent. In the case of *John Doe v. Bennett*,⁵ Chief Justice

McLachlin of the Supreme Court of Canada explained the rationale underlying the doctrine as follows:

Vicarious liability is based on the rationale that the person who puts a risky enterprise into the community may fairly be held responsible when those risks emerge and cause loss or injury to members of the public. Effective compensation is a goal. Deterrence is also a consideration. The hope is that holding the employer or principal liable will encourage such persons to take steps to reduce the risks of harm in the future.

It is evident from the foregoing that the purpose of tort law is not to punish wrongdoers but to provide damages to victims as compensation for their losses and that vicarious liability is a form of risk allocation. Since a penalty is a form of punishment, the doctrine of vicarious liability for tortious acts has no application to the law with respect to the imposition of penalties under the *Income Tax Act*. If there is to be a justification for applying the doctrine of vicarious liability in tax law, that justification must be found in criminal law.

Due diligence in Canadian criminal law

In the case of *R. v. Sault Ste. Marie*,⁶ the Supreme Court of Canada recognized three categories of offences:

1. Offences in which *mens rea*, consisting of some positive state of mind such as intent, knowledge, or recklessness, must be proved by the prosecution either as an inference from the nature of the act committed, or by additional evidence.
2. Offences in which there is no necessity for the prosecution to prove the existence of *mens rea*; the doing of the prohibited act *prima facie* imports the offence, leaving it open to the accused to avoid liability by proving that he took all reasonable care. This involves consideration of what a reasonable man would have done in the circumstances. The defence will be available if the accused reasonably believed in a mistaken set of facts which, if true, would render the act or omission innocent, or if he took all reasonable steps to avoid the particular event. These offences may properly be called offences of strict liability (...)

⁵ [2004] 1 S.C.R. 436, 2004 SCC 17, 2004 CarswellNfld 75 at para. 20. See <http://scc.lexum.org/en/2004/2004scc17/2004scc17.pdf>.

⁶ [1978] 2 S.C.R. 1299, 1978 CarswellOnt 24. See <http://scc.lexum.org/en/1978/1978scr2-1299/1978scr2-1299.html>.

3. Offences of absolute liability where it is not open to the accused to exculpate himself by showing that he was free of fault.⁷

The decision in the case of *Pillar Oilfield Projects Ltd. v. Canada*⁸ effectively recognized that penalties in the *Income Tax Act* which did not involve intent should fall within the second category and should be characterized as strict liability offences for which a due diligence defence is available:

Although Sopinka J. [in *R. v. Desousa* [1992] 2 S.C.R. 944 at p. 957] was speaking of criminal offences it is patent that the same reasons warrant an abhorrence of absolute liability in the case of administratively imposed penalties under fiscal statutes, on the other hand, as either requiring *mens rea* or as being absolute and susceptible of no defence. Such penalties can be substantial and in some cases crippling. The well-being or safety of the public is not at stake. Absolute liability for such penalties cannot be justified as a deterrent where the omissions or errors which the penalties are sought to deter could not have been avoided even by the exercise of the very due diligence that the imposition of the penalties is purportedly designed to encourage. The fact that permitting a defence of due diligence may be administratively burdensome to the Department of National Revenue is no justification for interpreting fiscal statutes in a manner that is contrary both to high judicial authority and to principles of fundamental justice and fairness.⁹

When one is charged with a strict liability offence, the prosecution must simply prove the commission of the prohibited act beyond a reasonable doubt. The defence may then avoid conviction by the successful presentation of what is commonly referred to as the “due diligence” defence. This defence must be proved by the defendant on a balance of probabilities.

As stated above, the due diligence defence will be successful if the defendant “reasonably believed in a mistaken set of facts which, if true, would render the act or omission innocent” or, if “he took all reasonable steps to avoid the particular event”. In assessing whether or not the defendant “took all reasonable steps” courts will examine whether or not the defendant had the control and the opportunity to

prevent the commission of the prohibited act. Indeed, the defendant’s liability is grounded in the fact that he had the power to prevent the commission of the act, and did not do so. Conversely, where the defendant is able to demonstrate that he did not have control or otherwise could not have prevented the commission of the act, he will be without fault.

The test for due diligence is a factual one, based on the defendant’s position with respect to the impugned act. The following statement made by Justice Dickson writing for the Supreme Court in *Sault Ste. Marie* addresses the issue of vicarious liability:

One comment on the defence of reasonable care in this context should be added. Since the issue is whether the defendant is guilty of an offence, the doctrine of *respondeat superior* has no application. The due diligence which must be established **is that of the accused alone**. Where an employer is charged in respect of an act committed by employee acting in the course of employment, the question will be whether the act took place without the accused’s direction or approval, thus negating willful involvement of the accused, and whether the accused exercised all reasonable care by establishing a proper system to prevent commission of the offence and by taking reasonable steps to ensure the effective operation of the system.¹⁰ (Emphasis added.)

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⁷ *Ibid.*, at pages 1326-1327 S.C.R.

⁸ 1993 CarswellNat 44, [1993] G.S.T.C. 49 (T.C.C. [Informal Procedure]).

⁹ *Ibid.*, at para. 22.

¹⁰ *Supra*, note 7 at page 1332.