REVENU QUÉBEC

INTERPRETATION AND ADMINISTRATIVE BULLETIN CONCERNING THE LAWS AND REGULATIONS

Income Tax

IMP. 128-11/R3 **Deductibility of fines and penalties**
Date of publication: **October 31, 2005**

Reference(s): *Taxation Act* (R.S.Q., c. I-3), ss. 128, 421.8, 1045 and 1049
An Act respecting the Ministère du Revenu (R.S.Q., c. M-31), ss. 59, 59.2, 59.2.1, 59.3, 59.4 and 59.5

Please withdraw bulletin IMP. 128-11/R2 dated May 31, 2005. This bulletin supersedes bulletin IMP. 128-11/R1 dated December 29, 1993.

This bulletin states the policy of the Ministère du Revenu du Québec concerning the deductibility of fines and penalties in computing a taxpayer's business or property income. It takes into account the harmonization measure announced by the Minister of Finance in the Budget Speech of March 30, 2004, concerning the deductibility of fines and penalties. It also takes into account the clarification made by the Ministère des Finances in Information Bulletin 2004-6 dated June 30, 2004, regarding the deductibility of tax penalties imposed as part of a new assessment issued after March 22, 2004. A revised version of the bulletin will be published once legislation enacting these measures has been assented to.

APPLICATION OF THE ACT

1. Under section 128 of the *Taxation Act* (TA), a taxpayer may deduct, in computing income from a business or property for a taxation year, only the outlays or expenses made or incurred by the taxpayer during that year or payable in respect of that year, to the extent that they may reasonably be regarded as being related to such business or property. In addition, the outlays or expenses must have been made or incurred during that year to gain income from the business or property and to the extent provided in Chapter III of Title III of Book III of Part I of the TA (sections 128 to 138, which deal with amounts that may be deducted in computing income), unless otherwise provided in Part I of the TA.

2. In its decision in *65302 British Columbia Ltd. v. Canada*, [2000] 1 CTC 57, 99 DTC 5799, rendered on November 25, 1999, the Supreme Court of Canada set out the general principles for determining whether a fine or penalty is deductible in computing income from a business or property.

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PRINCIPLES SET OUT BY THE SUPREME COURT OF CANADA IN THE *65302 BRITISH COLUMBIA LTD.* V. *THE QUEEN* DECISION

3. The following principles may be identified in this Supreme Court of Canada decision:

(a) the deduction of fines and penalties cannot be disallowed for reasons of public policy;

(b) a penalty or fine need not be unavoidable in order to be deductible;

(c) the characterization of an amount as a "fine or penalty" is of no consequence in determining its deductibility because the income tax system does not distinguish between fines and penalties;

(d) the question to be resolved in determining the deductibility of a fine or a penalty is the same as for any other expense: if the fine or penalty is incurred for the purpose of gaining or producing business or property income, it is deductible. The fine or penalty must therefore have been incurred for the purpose of gaining income from the underlying act or omission;

(e) if the underlying breach is egregious or repulsive, the fine or penalty subsequently imposed could not be justified as being incurred for the purpose of producing income;

(f) tax legislation may specifically provide that certain expenses are not deductible, even if such expenses would be deductible in accordance with the general principles. Thus, section 421.8 of the TA provides that, in computing income, no amount may be deducted in respect of an outlay made or expense incurred for the purpose of doing anything that is an offence or an indictable offence under section 3 of the *Corruption of Foreign Public Officials Act* (Statutes of Canada, 1998, c. 34) or under any of sections 119 to 121, 123 to 125, 393 and 426 of the *Criminal Code* (Revised Statutes of Canada, 1985, c. C-46) or an offence or indictable offence under section 465 of the *Criminal Code* as it relates to an offence or indictable offence described in any of those sections.

GENERAL PROHIBITION ON THE DEDUCTIBILITY OF A FINE OR A PENALTY

4. In the Budget Speech delivered on March 30, 2004, the Minister of Finance announced that Québec's tax legislation would be harmonized with the measure announced by the Minister of Finance of Canada in the Budget Speech of March 23, 2004, relating to fines and penalties (Budget Resolution 11), except in regard to the exception respecting penalty interest imposed under the *Excise Act* (R.S.C., 1985, c. E-14), the *Air Travellers Security Charge Act* (S.C., 2002, c. 9), and the GST/HST portions of the *Excise Tax Act* (R.S.C., 1985, c. E-15).

5. Thus, a fine or a penalty imposed after March 22, 2004, under a federal or provincial law, or under a law of a foreign country, is not deductible.

PENALTIES IMPOSED IN A FISCAL CONTEXT

6. In accordance with the principles set out in point 3 above, each of the following penalties is, as a rule, deductible in computing business or property income, provided it was imposed before

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March 23, 2004 (or after March 22, 2004, to the extent described in point 10 below), and provided it was incurred in one of the following situations:

(a) the penalty provided for in section 59 of the *Act respecting the Ministère du Revenu* (AMR) for failure to file a return or report as and when prescribed by a fiscal law;

(b) the penalty provided for in section 59.2 of the AMR for late payment or for failure to deduct, withhold or collect an amount under a fiscal law (for purposes of source deductions or consumption taxes);

(c) the penalty provided for in section 59.2.1 of the AMR for an excessive refund obtained further to a statement or omission made in a return filed under the *Act respecting the Québec sales tax* (R.S.Q., c. T-0.1) (AQST);

(d) the penalty applied for late filing of an income tax return (section 1045 of the TA).

7. The corresponding penalties provided for in the *Income Tax Act* (R.S.C., 1985, c. 1, 5th Supp.) (ITA) and in Part IX of the *Excise Tax Act* (ETA) are, as a rule, deductible in computing business or property income, provided they were imposed before March 23, 2004, and were incurred in order to gain income from such business or property.

8. However, the penalty for gross negligence provided for in section 59.3 of the AMR, the penalty for fiscal fraud provided for in section 59.4 or 59.5 of the AMR, or the penalty for false statements or omissions made knowingly or under circumstances amounting to gross negligence (section 1049 of the TA) are not deductible in computing business or property income, because such penalties are not, in all likelihood, expenses incurred in order to gain income from such business or property. This would be the case, for example, if a penalty were applied for gross negligence further to a failure to pay or remit an amount collected under the AQST. It should be added that, in such a case, the penalty provided for in section 59.2 of the AMR, which would be applied concurrently, would not be deductible.

9. The same is true of a penalty applied under the ITA or Part IX of the ETA with respect to a false statement or omission made knowingly or under circumstances amounting to gross negligence.

APPLICATION DATE

10. Further to an amendment announced by the Ministère des Finances in Information Bulletin 2004-6 dated June 30, 2004, a tax penalty imposed after March 22, 2004, as part of a new assessment may be deducted in computing a taxpayer's business or property income if such penalty was initially imposed by the tax authorities before March 23, 2004, and it then satisfied the conditions otherwise applicable to give rise to such deduction.

11. A fine or penalty imposed under a law after March 22, 2004, is not deductible, as indicated in point 5 above.

12. This policy applies from November 25, 1999, to March 22, 2004, to assessing actions or new assessing actions that include fines and penalties imposed before March 23, 2004.

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