

## Income Tax

**LMR. 59.5.3-1**      **Penalty for Misleading Information Provided by a Third Party**  
**Date of publication:**      **May 31, 2004**

Reference(s):      *An Act respecting the Ministère du Revenu* (R.S.Q., c. M-31), sections 59.5.1 to 59.5.9

The purpose of this bulletin is to set out the guidelines of the Ministère du Revenu concerning the applicability of the penalty for misleading information provided by a third party, as provided for in section 59.5.3 of the *Act respecting the Ministère du Revenu* (AMR).

This bulletin applies to any statement made after June 29, 2000. A penalty may therefore apply to any false statement given after that date.

### PRINCIPLE

1. The penalty for misleading information provided by a third party (“third party-penalty”) is applicable to persons who counsel others to file returns using false or misleading information, who turn a blind eye to false or misleading information submitted by their clients, or who omit information pertaining to Title I of the *Act respecting the Québec sales tax* (R.S.Q., c. T-0.1) (AQST).
2. This penalty does not apply to tax-planning arrangements that comply with Title I of the AQST, honest mistakes or actual oversights, activities that are administratively acceptable to the Ministère du Revenu, or differences of interpretations (for example, where the issue is not well-settled in jurisprudence).

### APPLICATION OF THE ACT

3. Under section 59.5.3 of the AMR, every person who makes a statement to another person (the “other person”), or assents to, acquiesces in or participates in the making of a statement by or on behalf of the other person, that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct, is a false statement that could be used by or on behalf of the other person for a purpose of Title I of the AQST is liable to a third-party penalty.
4. The penalty applied in respect of a false statement made by the person is equal to the greater of \$1,000 and the lesser of

- (a) the aggregate of \$100,000 and the person's gross compensation, at the time at which the notice of assessment related to the penalty is sent to the person, in respect of the false statement that could be used by or on behalf of the other person; or
- (b) 50% of the aggregate of all amounts each of which is,
  - i. if the false statement is relevant to the calculation of the other person's net tax for a reporting period, the amount, if any, by which the other person's net tax for the reporting period exceeds the amount that would be the other person's net tax for the reporting period if the statement were not a false statement,
  - ii. if the false statement is relevant to the calculation of the tax payable by the other person, the amount, if any, by which the tax payable exceeds the amount that would be the tax payable by the other person if the statement were not a false statement, and
  - iii. if the false statement is relevant to the determination of a rebate, the amount, if any, by which the amount that would be the rebate to which the other person would be entitled if the statement were not a false statement exceeds the amount of the rebate payable to the other person.

## **DEFINITIONS**

### **Person**

5. Pursuant to section 1 of the AQST, the word "person" includes a corporation, trust, individual, partnership or succession or a body that is an association, club, commission, union or other organization of any kind.

6. This definition applies for purposes of the third-party penalty (section 59.5.1 of the AMR).

7. Where two or more persons are involved in providing a false statement, the Ministère may apply the penalty to each of those persons.

### **Statement**

8. The word "statement" means any information provided orally or in writing, regardless of the medium.

Examples include information provided in returns, rebate applications, correspondence, invoices, statements, valuation reports, certifications, professional opinions, financial statements and their notes, contracts and prospectuses.

### **False Statement**

9. A "false statement" includes a statement that is misleading because of an omission from the statement.

10. However, for a third-party penalty to be applied in respect of a false statement, the Ministère must be able to demonstrate that the person knew, or would reasonably have been expected to

know but for circumstances amounting to culpable conduct, that the statement in question was a false statement that could have been used by the other person for the purposes of Title I of the AQST.

### **Culpable Conduct**

**11.** “Culpable conduct” means an act or a failure to act that

- (a) is tantamount to intentional conduct;
- (b) shows an indifference as to whether Title I of the AQST is complied with; or
- (c) shows a wilful, reckless or wanton disregard of Title I of the AQST.

**12.** Culpable conduct refers to conduct that is not simply an honest error of judgment, a misinterpretation of legislation or an actual oversight (that is, ordinary negligence). The concept of culpable conduct is defined with reference to the other types of conduct taken into consideration by the courts under tax law (for example, for the purposes of applying the penalty for gross negligence provided for in section 59.3 of the AMR).

• Intentional conduct

**13.** The expression “tantamount to intentional conduct” means conduct that is equal, in effect, to intentional conduct. This concept necessarily implies knowledge and the intention to make, or have the other person make, a false statement.

• Indifference

**14.** The expression “shows an indifference as to whether Title I of the AQST is complied with” describes the passive aspect of culpable conduct. A person demonstrates indifference where the person’s actions or failure to act indicate that the person was wilfully blind regarding the facts or the application of the tax legislation, or where the person suspects that the situation demands that certain questions be asked, but does not make inquiries.

• Wilful, reckless or wanton disregard

**15.** The expression “shows a wilful, reckless or wanton disregard of Title I of the AQST” points to the situation where a reasonable, prudent person would know that it is highly likely that a false statement could be made.

**16.** There is little difference in meaning between “wilful, reckless or wanton disregard” and “indifference”. Thus, in many cases, it may be concluded that a person who shows indifference as to whether Title I of the AQST is complied with also shows a wilful, reckless or wanton disregard of Title I of the AQST.

### **Participate and Subordinate**

**17.** For the purposes of the third-party penalty, the definition of “participate” includes causing a subordinate to act or to omit information, and knowing of, but not making a reasonable attempt to prevent, the participation by a subordinate in an act or omission of information.

**18.** The definition of “subordinate”, relating to a particular person, includes not only employees, but also other persons over whose activities the particular person has direction, supervision or control.

**19.** However, where the particular person is a member of a partnership, a person is not a subordinate of the particular person solely because the particular person is a member of the partnership. In other words, a person who reports to a particular partner is a subordinate of that particular partner and not of any other partner unless that person also reports to that other partner.

## **TERMS OF APPLICATION**

### **Factors to Be Considered**

**20.** Whether penalties will be assessed in a given situation will depend on the facts of the situation and on whether the person liable to the penalties is credible or is considered to have acted in good faith.

**21.** The following factors may be considered by the Minister in determining whether a third-penalty is to be applied:

- (a) whether the position taken is obviously wrong, unreasonable, or contrary to well-established jurisprudence;
- (b) whether the false statements or omissions have occurred repeatedly;
- (c) considering the person’s experience with the relevant subject matter and knowledge of the other person’s specific financial situation, whether the person knew that statements were false or deliberately participated in making false statements;
- (d) whether the amounts omitted are significant; and
- (e) whether the culpable conduct represents the most aggressive and blatantly abusive behaviour.

**22.** No single factor is a determining factor. All factors must be considered together.

### **Clerical or Secretarial Services**

**23.** Pursuant to section 59.5.5 of the AMR, a person is not considered to have made or furnished a false statement, or assented to, acquiesced in or participated in the furnishing of a false statement, solely because the person provided clerical services (other than bookkeeping services) or secretarial services in respect of the statement.

**24.** Clerical or secretarial services, such as typing, are considered to be of an administrative nature, without having any regard to content other than the accurate reproduction of originals that are prepared by others.

### **Advisor**

**25.** Pursuant to section 59.4.5 of the AMR, a person (the “advisor”) who acts on behalf of the other person is not considered to have acted in circumstances amounting to culpable conduct in respect

of the false statement solely because the advisor relied, in good faith, on information provided to the advisor by or on behalf of the other person or, because of such reliance, failed to verify, correct or investigate the information.

**26.** An advisor is considered to have acted in good faith where the advisor used the information without dishonest intentions and had no reason to doubt the accuracy of the information.

**27.** This exception is available where the information used by the advisor is not, on its face, clearly false, or obviously unreasonable to a prudent person.

## **Employees**

**28.** Under section 59.5.8 of the AMR, the third-party penalty does not apply to an employee of the other person (except a specified employee as defined in section 1 of the *Taxation Act* (R.S.Q., c. I-3)) to the extent that the false statement could be used by or on behalf of the other person for a purpose of Title I of the AQST.

**29.** In addition, the conduct of the employee is deemed to be that of the other person for the purpose of applying the penalty for gross negligence provided for in section 59.3 of the AMR.

**30.** This exception does not apply to employees of a tax return preparer whose services are retained by the other person.

**31.** However, in the case of certain groups of corporations, an employee of a particular corporation maintains the accounting records and does tax planning and tax return preparation for the entire group. Such an employee is not technically covered by the exception provided for in point 28 with respect to the work carried out for the other members of the group. However, in such a situation, the Ministère would assess the third-party penalty against the employer (the particular corporation) and not the employee, unless the duties were entrusted to the employee to avoid the third-party penalty.

**32.** If the facts show that an employee in the situation described in point 31 participates in activities in respect of which a third-party penalty could be applied, without the employer's knowledge, only the employee is liable to the penalty.

## **False Statements in Prior Periods**

**33.** Where a person discovers that another person made a false statement respecting a prior period, the person is required to rectify the situation in the tax return for the current period, to the extent that the false statement affects that return. Otherwise, the person is liable to a third-party penalty.

**34.** If, for example, the person advises the client to make a voluntary disclosure respecting the prior periods in accordance with the Ministère's policy described in the current version of interpretation bulletin ADM. 4, and the client does not follow this advice, the person is not exposed to the third-party penalties in respect of the prior periods.

## **General Anti-Avoidance Rule**

**35.** The third-party penalty does not apply to arrangements solely because they are subject to the application of the general anti-avoidance rule, since the arrangements are not necessarily based on false statements. However, if a person takes a filing position contrary to well-settled jurisprudence on an identical issue, the third-party penalty may be considered.

## **BURDEN OF PROOF**

**36.** Under section 59.5.9 of the AMR, the burden of establishing the facts justifying the applicability of the third-party penalty provided for in section 59.5.3 of the AMR is on the Ministère. The standard of evidence used for third-party penalties is the balance of probabilities, with the benefit of the doubt going to the third party.

## **PROFESSIONAL STANDARDS**

**37.** The accountants' Notice to Reader communication, as described in the Canadian Institute of Chartered Accountants Handbook, is not considered to be an admission of indifference as to whether Title I of the AQST is complied with. In all cases, the Ministère must determine whether the false statement was made knowingly or in circumstances amounting to culpable conduct.

**38.** A disclaimer of a person's responsibility for information received from the client does not absolve the person from a penalty if the conditions for applying the penalty exist.

**39.** Persons are not necessarily liable to a third-party penalty solely because they are subject to sanctions by professional bodies or have committed malpractice.

## **PROCESS**

**40.** The Ministère intends to strictly control the application of the third-party penalty to ensure that it is imposed in a fair and consistent manner. The Ministère also undertakes to apply the penalty only in egregious situations.

**41.** Where an auditor is considering applying a third-party penalty, he or she must first obtain authorization from a manager appointed by the Ministère before initiating a penalty audit.

**42.** Where this manager determines that it is appropriate to conduct an audit, the Ministère will inform the person that the person will be audited for a possible penalty application.

**43.** If, after reviewing the facts, the Ministère determines that a penalty may be applied, the person concerned will be so informed by letter and will have 30 days to submit a response. The letter will set out the essential factors on which the Ministère will base its decision.

**44.** If, after the expiration of the 30-day period, the audit branches of the Ministère still wish to apply the penalty, they must obtain the approval of the Direction générale de la législation et des enquêtes before applying the penalty and issuing an assessment, if applicable.

**45.** A third-party penalty assessment issued by the Ministère is subject to objection and appeal in accordance with the regular procedures provided for in sections 93.1.1 to 93.35 of the AMR.

**46.** If the other person, within the meaning of point 3, contests an assessment arising from a false statement (in respect of which a third-party penalty is applied), the Direction des oppositions de Montréal or the Direction des oppositions de Québec will not make a decision regarding the third-party penalty until a final decision has been made regarding the other person's objection or appeal.