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## **The Power of CRA to Penalize Taxpayers Who Have Not Complied with the Income Tax Act**

*By Gregory Sanders*

The *Income Tax Act* (the “*Tax Act*”) operates as a self-assessing and reporting system of taxation. This means that taxpayers resident residing in Canada are required to accurately report their income under Canadian tax law. CRA reserves the right, within a reasonable time frame, to review taxpayer’s filings to determine if they are accurate or not. Where taxpayers routinely do not comply with reporting and compliance provisions or their reporting is negligent or willfully inaccurate, CRA has the power to penalize those taxpayers in a variety of ways. Most of the penalties that CRA assesses are a percentage of income that was not reported or taxes that were owed. CRA also has the power to assess penalties based on the number of days that a return is filed late, even if there is no direct tax liability associated with the failure.

Generally speaking, the most common penalty assessed by CRA is a late filing penalty for taxpayers who file their returns beyond the normal filing deadline. The penalty is five percent (5%) of the tax payable for the year, plus an additional one percent (1%) of the amount of tax owing for each month that the return was late to a maximum of seventeen percent (17%) of the unpaid tax. If a taxpayer continues to late file their returns, the penalties can double.

If a taxpayer has not accurately reported all of the income earned in any two (2) of the last four (4) years, they can also be subject to a penalty of ten percent (10%) of the amount of income that was not reported on their returns. The situation gets worse if CRA determines that the failure to report income was done knowingly or in circumstances amounting to gross negligence. In such a case, the penalty is fifty percent (50%) of the tax that would otherwise be payable on that unreported income.

After this, CRA has powers to escalate their investigation to the point where they may determine that a taxpayer is carrying out the criminal offense of tax evasion. This could lead to penalties of up to two hundred percent (200%) of the tax owing, and possibly jail.

CRA can also assess a penalty for failure to provide certain information returns. Typically this penalty is equal to \$25.00 for each day that the return is late filed to a maximum of \$2,500. This penalty applies whether there is tax owing or not. For example, CRA has increased their information collection rights on Canadians who hold assets outside of Canada. As a result, foreign based information returns are required to be filed where a Canadian taxpayer owns non-Canadian assets. The failure to file these information returns can also attract a penalty of \$25.00 per day to a maximum of \$2,500.

Where the *Tax Act* requires CRA to automatically assess a penalty (as is the situation where a taxpayer does not report of all of its income in two (2) of the last four (4) years), the taxpayer still can raise a due diligence defence. Traditionally, taxpayers have had



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limited success when challenging these penalties. Taxpayers also have a defence when gross negligence penalties are assessed on the basis that their failure was not made knowingly or with indifference as to whether the law was complied with or not. This is a very factual based test that can be hard to establish without evidence in favour of a taxpayer.

Where CRA suspects that a criminal act of tax evasion is taking place, they must notify the taxpayer as soon as they come to this conclusion and the taxpayer then has the rights afforded to them under the criminal code which includes the right to a lawyer and the right not to incriminate themselves.

Over the years, with the added pressures of recessions and failed economies and the growing underground economy, taxpayers are more and more putting themselves in harms way in connection with paying the tax that is due on their income. CRA has been aggressively pursuing taxpayers and is more willing than ever to assess penalties where they feel that the circumstances warrant such action, and taxpayers are finding themselves having to defend not only their failure to report their income but the reasons why they failed in attempts to reduce their exposure to penalties.

As CRA is the main tool of the government for collection of revenue to pay for their program spending, the pressure will always be on to ensure that Canadian taxpayers properly report their income and do not take advantage of the fact that the self-assessing system may encourage them to under-report their income.

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