

# THE CANADIAN TAXPAYER

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## The CRA Head Office and Nero: Both Fiddled While Their Charges Burned

David H. Sohmer

In 2011, Richard Montroy, who was then CRA Deputy assistant commissioner, Compliance Programs Branch, made the following statement:

I would like to mention a couple of things I hear from many people that there is an adversarial relationship with the CRA. However, I personally don't think that it is any different than it was 20 years ago. I think perhaps what is a little different now is that when something happens, everyone knows about it. I also think that it is the way the game is. In the private sector, your objective is to try to minimize taxes for your client, in government, it is to make sure that, in our opinion, the right amount of tax is assessed. These are two diametrically opposed views.<sup>1</sup>

What not everyone knew, but which Mr. Montroy and his head office cohort should have known, was that in the prior 20 years there were systemic "irregularities" in the way the "game" was played at the Montreal Tax Services

Office (the "TSO"). Two recent decisions by the Cour du Québec (*Accurso c. R.*,<sup>2</sup> and *R. c. Bruno*<sup>3</sup>) and one by the Federal Court (*Furgiuele c. Agence du revenu du Canada*<sup>4</sup>), expose details that were previously unavailable to the public. The decisions refer to seven investigations of CRA employees at the TSO that were active in the decade before Mr. Montroy made his statement: *Projet Cocagne*, *Projet Delvex*, *Projet Infiltration*, *Projet Colisée*, *Projet Coche*, *Projet Carrera*, and *Projet Critique*. The decisions also refer to more than 25 individuals by name who had knowledge of irregularities at the TSO. The judge in *Bruno* notes that the launching of *Projet Cocagne* in 2000 confirmed that the preoccupation with corruption at the CRA was not new.<sup>5</sup> Particularly disconcerting is the observation by the judge in *Accurso* that the 2003 *Projet Cocagne* report, which "dealt with suspected collusion between taxpayers and corrupt CRA agents accepting bribes and agents not respecting their Code of integrity

<sup>1</sup> Ron Mar, Richard Montroy, et al, "Hot Audit Issues" 2012 CR 3:1-20.

<sup>2</sup> 2019 QCCQ 3705, 2019 CarswellQue 4744, EYB 2019-313126, [2019] G.S.T.C. 46 (C.Q.).

<sup>3</sup> 2018 QCCQ 5174, 2018 CarswellQue 9013, EYB 2018-303133 (C.Q.).

<sup>4</sup> 2017 CF 268, 2017 FC 268, 2017 CarswellNat 687, 2017 CarswellNat 7713, [2018] 5 C.T.C. 109 (F.C.).

<sup>5</sup> *Bruno* at para 43.

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and professional conduct," was only given to the director of the TSO in 2008.<sup>6</sup>

The *Furgieue* decision provides a detailed description of the inner workings at the TSO. Joe Oliverio, an audit manager who had worked for the CRA for 25 years, was contacted by an investor in a software scheme that the

CRA later described as a sham involving worthless software. The investor (Gemmar), wanted confirmation that the software was not a tax shelter. The judge noted that "it was not normal for a taxpayer to contact a CRA manager directly rather than inquiring with CRA Headquarters." Furgieue, who had worked for the CRA for 18 years was a team leader who reported to Oliverio (Oliverio and Furgieue are collectively referred to as the "applicants" in the judgement). The following is an excerpt from the English translation of the judgment:

[5] The applicants then asked Josée Bissonnette, an auditor on the team, to conduct an audit to determine whether the purchase of the software represented a tax shelter. When she left on maternity leave, the applicants reassigned that audit to Geneviève Robillard, a junior auditor.

[6] Ms. Robillard explained that she was not comfortable carrying out that mandate and that she had basic knowledge (Ed: "connaissances élémentaires") in that area. As such, she suggested that the matter be transferred to the tax avoidance team. However, Mr. Oliverio asked that Ms. Robillard handle the matter.

[7] Ms. Robillard followed Mr. Oliverio's orders. She finally prepared a letter to Gemmar on December 8, 2008, in which she stated that the acquisition of the software did not constitute a tax shelter. This therefore represented significant tax consequences for Gemmar.

[8] On April 13, 2010, Mr. Oliverio and the Assistant Director, Audit requested a review of Ms. Robillard's audit report. That review was conducted by Ralph Amar, an auditor in the Aggressive Tax Planning Division (previously "Tax Avoidance") at the Montréal Tax Services Office.

[9] Given the complexity of the file, Mr. Amar contacted his union, as he was not comfortable with that work assignment. Despite his reservations, he finally prepared his report on October 15, 2010, finding that "[...] in the absence *prima facie* of any *indicia* as to statements or representations, I concur with the view of the previous auditor that the acquisition of the interest in the software by the taxpayer is not an acquisition of a 'tax shelter,' as defined in the Act."

The members of Head Office should be subject to the same duties as are directors of corporations, namely (1) to supervise the activities of the corporation; (2) to remain informed about the corporation's activities; and (3) to ensure that the corporation's activities are legal and in the best interests of the corporation. Not one member of Head Office acknowledged that he or she may have been derelict in complying with these duties. Not one CRA Annual

<sup>6</sup> *Accurso* at para 48 and at footnote 61.

Report to Parliament mentioned issues with respect to the “irregularities”. To appreciate how this came to pass, one must go back to the decision taken in 1987 to decentralize tax administration and to decrease Head Office personnel. Ed Gauthier, who was then the Director General of the Audit Directorate, described the process as follows:

In the past couple of years, the tax-avoidance staff in our field offices have been empowered with all tax-avoidance processing and assessing functions in order to give you faster and more responsive service. The only exception to this decentralization is general anti-avoidance rule (GAAR) reassessments, which still must be approved by Head Office.

Head Office is responsible for establishing the programs for the field, procedures, and guidelines, and for providing, on request, technical or other assistance. Head Office is also responsible for ensuring that there is consistency in the field through training, communications, program reviews, and coordinating national issues or subjects.

I will emphasize that the district offices are now in charge of the audit and they are the ones that are delivering the programs. Head Office is there to advise and assist. This is so even in subsection 55(2) cases, swaps, or whatever.”<sup>7</sup>

The decentralization and the accompanying decrease in the number of Head Office personnel transformed Head Office into an insular body that is removed from the activities of the Tax Services Offices and that is seldom held to account. Even on the rare occasion when the media holds it to account there are no *mea culpas*. The testimony to the House of Commons Finance Committee in the KPMG/Isle of Man affair is an example.<sup>8</sup> If nothing changes the past will surely be prologue.

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## Estate Freezes: Nothing GAARable About Them

Joel Nitikman

On August 20, 2019, Mr. Allen Lanthier, a former tax accountant, wrote an article for the *Financial Post*.<sup>1</sup> In the article Mr. Lanthier argued that estate freezes do not work technically and if they do then the Canada Revenue Agency (the “CRA”) should attack them under the general anti-avoidance rule (“GAAR”) in subsection 245(2).<sup>2</sup> His article was criticized by a number of commentators<sup>3</sup> and on September 5, 2019, Mr. Lanthier published a rebuttal.<sup>4</sup>

It is the author’s opinion that Mr. Lanthier’s opinion of estate freezes is misplaced and, in my view, he has made a fundamental mistake with respect to the method of determining the fair market value (“FMV”) of common shares, which mistake undermines his opinion.

To underscore my opinion, let’s review the example Mr. Lanthier used:

John is widowed and has three adult children. John owns 100 percent of the shares of a Canadian private corporation (“Canco”). The shares have a nominal tax cost and a value of \$10 million. John expects this value to increase to at least \$100 million by the time of his death, and he wants to avoid the tax of more than \$25 million that would be payable when he dies and leaves the shares to his children.

John therefore implements a freeze. He surrenders his Canco shares for \$10 million of new voting, retractable preferred shares. The expectation is that this share exchange will not result in any immediate income tax. His children then subscribe for new common shares, paying a nominal amount. The planning assumes that the common shares have no

<sup>7</sup> E. H. Gauthier, “Audit Function in Revenue Canada Taxation”, 1992 CR 9E 1-8 at pp 3-4.

<sup>8</sup> See David H. Sohmer, “A CRA All Star Tag Team v. Gaston Gauthier: Politic Trumps Transparency”, *The Canadian Taxpayer* (February 8, 2019, Vol. xli No. 3) at pp. 17-20.

<sup>1</sup> Allen Lanthier, “Rich Canadians are getting out of paying taxes with ‘estate freezes’ — and the CRA endorses it”, online National Post: <https://nationalpost.com/opinion/rich-canadians-are-getting-out-of-paying-taxes-with-estate-freezes-and-the-cra-endorses-it/wcm/20969fbb-15c0-4c19-b2e5-1f22c379e6ec#comments-area>.

<sup>2</sup> All statutory references are to the *Income Tax Act*, R.S.C. 1985, c. 1 (5<sup>th</sup> Supp.), as amended (the “Act”).

<sup>3</sup> See, for example, Peter Creaghan, “Are Wealthy Canadians Really Avoiding Taxes with Estate Freezes?” (September 2019), online CMG: <http://www.cmgpartners.ca/estate-freezes>; Kim Moody, “Estate Freezes: Should they be legislated out of existence?” (August 28, 2019), online Canadian Accountant: <http://www.canadian-accountant.com/content/profession/estate-freezes-should-they-be-legislated-out-of-existence>.

<sup>4</sup> Allan Lanthier, “Why some Canadian accountants are wrong about estate freezes” (September 5, 2019), online Canadian Accountant: <http://www.canadian-accountant.com/content/business/why-some-canadian-accountants-are-wrong-about-estate-freezes>.