

Canadian Litigation Hits 'New Normal' After Record Reassessments

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Increased litigation among high-risk taxpayers at various stages of the audit process is likely here to stay, according to the Canada Revenue Agency, but practitioners warn of the potential for collateral damage.

The CRA has [roughly doubled the amounts at stake in its audits](#) in recent years, leading to a corresponding increase in taxpayer litigation. Both the agency and members of the private bar agree that the effects are likely to be lasting.

The CRA reassessed a record C \$14.4 billion in fiscal 2018-2019, including penalties, according to agency spokesman Etienne Biram. "In recent years, the CRA has made over [C] \$12 billion in gross audit assessments every year, over 60 percent of which is related to tax avoidance by large multinational corporations and aggressive tax planning by wealthy individuals," Biram said in an email. Those two categories of taxpayers represent more than half of the agency's fiscal impact results, annually, he added.

The increased litigation is attributable to its focus on high-risk taxpayers, Biram said. "This group can have more opportunity and the means to be involved in aggressive tax planning strategies, leverage complex offshore structures, and challenge the CRA in court at every turn," he said. Over a quarter of the 12,000 cases at the Tax Court of Canada involve "the most significant, complex audit matters, including tax avoidance schemes and strategies used by sophisticated taxpayers such as large corporations and high-net-worth individuals," he said.

Practitioners say those statistics are consistent with what they see in private practice. "We've seen a noticeable increase in the last five years with audit activity and with reassessment," as well as an increased focus on high-net-worth people and successful businesses, said Kim Moody of Moodys Tax Law LLP. The increased activity "in some cases is just nuisance, and in some cases is very disruptive and intrusive," though some reassessments are of course legitimate, Moody said.

Drew Gilmour of Schmidt & Gilmour Tax Law LLP said he has frequently seen low-net-worth individuals assessed for hundreds of thousands of dollars that they didn't owe. Ron Choudhury of Miller Thomson LLP also said he's seen taxpayers caught up in high-net-worth audits when they have no business being there, as well as sales tax audits that don't seem grounded in law.

Moody wondered how much of the increased audit activity is being conducted by inadequately trained employees. “When you have a bunch of inexperienced . . . people running around, it does cause disruption” in what should be a cooperative relationship between the taxpayers and the CRA, he said.

“The average CRA auditor we’re seeing today, as opposed to five or 10 years ago, is not as experienced,” Choudhury said. It almost seems as though “the hope is to assess as much as possible in the belief that the taxpayer will just want to resolve the matter and move on,” but amounts at issue are becoming so large that taxpayers aren’t motivated to just pay and walk away, he said.

Much of the uptick in audit amounts is probably related to the increased imposition of gross negligence penalties, Gilmour said. Historically, those penalties were reserved for exceptional circumstances, but they now appear to be many auditors’ default position, he said. “We have heard from former CRA employees that auditors have been required to justify, internally, why they were not assessing penalties, rather than why they were.”

“You’re looking at one side of the story if you think that the litigation is happening just because the taxpayer is being aggressive; the litigation is also happening because there are a lot of assessments out there which have no basis or limited basis in law,” Choudhury said.

Looking Abroad

Canada’s government has invested heavily in combating international tax evasion, spending C \$350 million annually since budget 2016 to “target complex tax schemes in areas such as offshore tax evasion and the underground economy,” according to the [Fall Economic Statement 2020](#) presented by Finance Minister Chrystia Freeland November 30.

The statement proposes an additional investment of C \$606 million for five years and the hiring of “offshore-focused auditors to focus on individuals who avoid taxes by hiding income and assets offshore.” Recent investments targeting tax avoidance and evasion have yielded more than C \$3 billion in revenue, according to estimates, and new measures are expected to deliver an additional C \$1.4 billion over five years, the statement says.

“I think it’s a pipe dream to suggest that there’s billions and billions of dollars offshore. I just don’t believe it, and I certainly don’t see it in my day-to-day practice,” Moody said.

The CRA reported during an annual STEP Canada/CRA Roundtable November 26 that the offshore tax informant program, through which the CRA rewards informants for tips about international tax evasion, had received over 1,600 calls from potential informants and executed almost 50 informant contracts as of December 31, 2019. “Nearly [C] \$60 million has been assessed, of which approximately [C] \$20 million has been collected, and over 300 audits of taxpayers are in progress,” the CRA said.

Collections of C \$20 million seem staggeringly low compared with the amount invested in the CRA’s focus on offshore matters, Moody said. He questioned the grounds for what he described as the government’s “continuing infatuation with offshore,” adding, “The average person is not

putting money offshore and not paying their tax.”

Choudhury noted that there is a level of knowledge, understanding, and sophistication required for offshore investigation and enforcement. “It’s not just about throwing money at a problem,” he said.

Looking Ahead

Increased litigation among high-risk taxpayers “can be seen as the new normal,” CRA spokesperson Christopher Doody told *Tax Notes*.

“There are people who deserve to be taxed and penalized, and who are engaging in blatant evasion,” Choudhury said. But a lot of people who shouldn’t be in the system are getting caught up in it, he said, adding, “I don’t expect this to change.”

In light of historical levels of government spending because of the COVID-19 pandemic, “we may actually see even more of a push for revenue generation,” Choudhury said. A high-tax country like Canada may focus on generating revenue through enforcement, rather than increasing taxes, he said.

The CRA is working to speed the dispute resolution process, Doody said. “In response to the increased litigation in many highly complex and contentious cases, lawyers now work alongside senior technical advisory specialists to assist audit teams” and ensure legal defensibility of proposed reassessments, he said.

In private practice, the increased litigation has led to a greater involvement of tax planning lawyers in litigation matters, Choudhury said. “Law firms are bulking up on their tax litigation side,” he said.