The Billionaire's Audit: Québec Taxpayer Awarded Damages for Negligent RPI Audit

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Summary

In 2005, the Canadian Revenue Agency (CRA) launched the Related Party Initiative (RPI), more commonly referred to as the High-Net-Worth Project or the Billionaire's Audit. The objective of the RPI is to target high net worth individuals who have been identified by the CRA as having paid relatively little tax and perform an in-depth audit on their finances.

One of the individuals targeted by the RPI was a shareholder (Taxpayer) of St. Lawrence Trading Inc. (SLT), a legal entity incorporated in the British Virgin Islands to manage a portfolio of investments. The investments made through SLT were the root cause of the RPI audit. SLT became of interest to the CRA when the Taxpayer filed a tax form in which he declared that he had purchased his SLT shares for $1,364,864 and that they now had a fair market value of $16,063,763. However, no taxes had been paid on this gain. A lengthy audit — beginning in 2006 and ending in 2012 — resulted in a reassessment to the Taxpayer totaling more than $25 million in unpaid taxes, interest and penalties. In 2014, the CRA abandoned and/or reversed many of these assessments and the Taxpayer alleged that the CRA acted unreasonably and negligently. The Taxpayer therefore sued the CRA for damages.

The Decision

In its decision, the Québec Superior Court outlined a standard code of conduct that the CRA must satisfy during the course of an RPI audit. The court determined:

- (i) The CRA must act reasonably throughout the course of an audit;
- (ii) Negligence on the part of the CRA was sufficient to establish fault;
- (iii) The CRA does not commit a fault if it reasonably takes a position which ultimately turns out to be wrong; and
- (iv) The CRA must not exercise its power under the *Income Tax Act* in an abusive way.

In this case, the court ordered the CRA to pay $4.8 million in damages for committing several faults throughout the protracted and abusive tax audit. The Court determined that the CRA was at fault for the following reasons:

- (i) The CRA took, and clung onto, unreasonable assessing positions and issued unreasonable final assessments that it had never applied to any other taxpayer;
- (ii) The CRA failed to give the Taxpayer prior notice before issuing the final reassessments;
- (iii) The CRA did not provide adequate responses to requests for information;
- (iv) In the course of exchanges with the Bermudan authorities, the CRA referred to the audit as a "criminal tax matter," which was false; and
- (v) The CRA made settlements in bad faith, offering to give up positions it knew were unfounded in order to try to extract as much tax as possible.

Takeaway

Although ordinary Canadians without deep pockets are often at the mercy of the CRA, tax authorities are not absolute and taxpayers should not be subject to bullying tactics during an audit. In this decision, the CRA was found liable for negligence following unreasonable audits resulting from a RPI audit. Taxpayers who receive inquiries relating to an RPI audit are advised to retain accountants and legal counsel so as to mitigate any potential legal and financial risks they may be exposed to.

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