

Income Tax

IMP. 1049.0.5-1/R1

Penalty for Misleading Information Provided by a Third Party

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Reference(s):

Taxation Act (CQLR, c. I-3), sections 1049.0.3 to 1049.0.11

This version of interpretation bulletin IMP. 1049.0.5-1 replaces the version of May 31, 2004. The bulletin has been updated to reflect legislative amendments, changes to the framework for the penalty for misleading information provided by a third party and the creation of the Comité d'examen de la pénalité aux tiers (third-party penalty review board) at Revenu Québec. This bulletin applies to all statements made after June 29, 2000.

The purpose of this bulletin is to set out Revenu Québec's guidelines for applying the penalty for misleading information provided by a third party (third-party penalty) provided for in section 1049.0.5 of the *Taxation Act* (TA).

The guidelines set out in this bulletin also apply to the third-party penalty provided for in section 1049.0.5.1 of the TA.

PRINCIPLE

1. The third-party penalty applies to persons who counsel others to file returns or prepare returns themselves using false or misleading information. It also applies to persons who provide false or misleading documents to their clients, who turn a blind eye to false or misleading information submitted by their clients, or who omit information pertaining to the TA.
2. The penalty does not apply to tax-planning arrangements that comply with the TA, honest mistakes, oversights or differences of interpretation (for example, where the issue is not well-settled in jurisprudence).

APPLICATION OF THE ACT

3. Under section 1049.0.5 of the TA, every person who makes a statement to another 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 the TA 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 penalty to which the other person would be liable under section 1049 of the TA if the other person had made the statement in a return filed for the purposes of the TA and had known that the statement was false; and
- (b) the aggregate of \$100,000 and the person's gross compensation, at the time at which the notice of assessment of 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.

DEFINITIONS

Person

5. Pursuant to section 1 of the TA, the word "person" includes any corporation and any entity exempt from tax under Book VIII of the TA. It also includes the legal representatives of such a person, according to the law of that part of Canada to which the context extends. For the purposes of the third-party penalty, section 1049.0.3 of the TA provides that the word "person" includes a partnership.

6. In accordance with section 1049.0.11 of the TA, where a partnership is liable to a third-party penalty, the provisions concerning, among other things, assessments apply (with the necessary modifications) to the penalty as if the partnership were a corporation.

7. Where two or more persons are involved in the making of a false statement, Revenu Québec may apply the penalty to each person.

Statement

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

Examples include information provided in income tax returns, tax credit forms, election forms, correspondence, invoices, receipts, 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, Revenu Québec 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 the TA.

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 the TA is complied with; or
- (c) shows a wilful, reckless or wanton disregard of the TA.

12. In the absence of proof of a third party’s knowledge of a false statement, it is sufficient to establish that the third party would reasonably be expected to know that the statement was false, but for circumstances amounting to culpable conduct. Thus, culpable conduct does not constitute an honest error of judgment, a misinterpretation of legislation, an oversight or ordinary negligence on the part of the third party, and the standard to be applied must be at least as strict as for gross negligence under section 1049 of the TA. The penalty applied to the third party is intended to punish serious misconduct.

• 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 word “indifference” with regard to compliance with the TA 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 does not make additional inquiries regarding a questionable situation.

• Wilful, reckless or wanton disregard

15. The expression “shows a wilful, reckless or wanton disregard of the TA” describes a 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 the TA is complied with also shows a wilful, reckless or wanton disregard of the TA.

Participate and Subordinate

17. For the purposes of the third-party penalty, the word “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 word “subordinate”, relating to a particular person, includes any person, whether or not an employee of the particular person or of another person, whose activities are directed, supervised or controlled by the particular person.

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, the evidence, the applicable legislation and whether the person liable to the third-party penalty 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-party 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 abusive and manifestly deceptive behaviour.

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

Clerical or Secretarial Services

23. Pursuant to section 1049.0.7 of the TA, 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 services include activities of an administrative nature that seek only to reproduce documents prepared by others (for example, entering information into a software program).

Advisor

25. Pursuant to section 1049.0.6 of the TA, 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. For example, 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 1049.0.10 of the TA, 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 TA) to the extent that the false statement could be used by or on behalf of the other person for a purpose of the TA.

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 1049 of the TA.

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 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, Revenu Québec would assess the third-party penalty against the employer (the 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, without the employer's knowledge, in activities in respect of which a third-party penalty could be applied only the employee is liable to the penalty.

False Statements in Prior Years

33. Where a person discovers that another person made a false statement respecting a prior taxation year, the person is required to rectify the situation in the tax return for the current year, 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 years in accordance with Revenu Québec's policy described in the current version of interpretation bulletin ADM. 4, *Voluntary Disclosure Program*, and the client does not follow this advice, the person is not exposed to the third-party penalties in respect of the prior years.

Price Adjustment Clause

35. Where a price adjustment clause has been provided for in accordance with the interpretations and positions given by the Canada Revenue Agency (CRA) in Income Tax Folio S4-F3-CI, *Price Adjustment Clauses*, there would not be a false statement made with actual knowledge or in circumstances amounting to culpable conduct since the parties (the vendor, the purchaser and Revenu Québec) have agreed to agree on a revised value of the transferred property.

General Anti-Avoidance Rule

36. 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

37. Under section 1050 of the TA, the burden of establishing the facts justifying the applicability of the third-party penalty provided for in section 1049.0.5 of the TA is on the Minister. The standard of evidence for penalties is the balance of probabilities.

PROFESSIONAL STANDARDS

38. The accountants' Notice to Reader communication, as described in the CPA Canada Handbook - Assurance, is not considered to be an admission of indifference as to whether there is compliance with the TA. In all cases, Revenu Québec must determine whether the false statement was made knowingly or in circumstances amounting to culpable conduct.

39. Where the conditions for the application of the third-party penalty have been met, a person may be liable to a penalty even if a disclaimer has been signed regarding responsibility for information provided by their client.

40. A person is not necessarily liable to the third-party penalty solely because they are subject to sanctions by professional bodies or have committed malpractice.

PROCESS

41. Revenu Québec intends to strictly control the application of the third-party penalty to ensure that it is imposed in a fair, coherent and consistent manner. Revenu Québec also undertakes to apply the penalty only in egregious situations.

42. The Comité d'examen de la pénalité aux tiers (CEPAT-IMPÔT), coordinated by Revenu Québec's Direction de l'interprétation relative aux mandataires et aux fiducies (DIRMF), oversees the application of the third-party penalty and ensures that it is applied fairly, coherently and consistently. At the end of the process, CEPAT-IMPÔT conducts an additional review of all third-party penalties before an assessment is made.

- 43.** If the audit unit determines that there are grounds to conduct an audit of the third party, it must obtain the DIRMF's approval before initiating a third-party penalty audit. It must also provide the DIRMF with the complete file and a situation report.
- 44.** If, after reviewing the file, the DIRMF grants its approval, the audit unit will then inform the person (third party) that they will be audited for a possible application of the third-party penalty.
- 45.** If the audit unit of the branch concerned recommends imposing the penalty, it must prepare a recommendation report for CEPAT-IMPÔT.
- 46.** On the basis of the recommendation report, CEPAT-IMPÔT may support or reject the third-party penalty recommendation, or request additional information before issuing its final recommendation. If additional information is required, the file will be resubmitted to CEPAT-IMPÔT.
- 47.** If CEPAT-IMPÔT recommends a third-party penalty, the audit unit will send the person a letter informing them of Revenu Québec's intention to impose the penalty. The letter must explain the basis for Revenu Québec's decision. The person will then have 30 days to make representations and provide additional information.
- 48.** If no additional information is received, the audit unit can impose the third-party penalty and send a final letter informing the person that a notice of assessment will be issued.
- 49.** If additional information is received in response to the letter of intent to impose the third-party penalty, the audit unit will need to seek approval from CEPAT-IMPÔT on whether to uphold the decision to impose the penalty. If it is upheld, the audit unit can then impose the third-party penalty and send a final letter informing the person that a notice of assessment will be issued.
- 50.** If CEPAT-IMPÔT rejects the third-party penalty recommendation, the audit unit will inform the third party in writing and close the file.
- 51.** A notice of assessment issued by Revenu Québec regarding the application of the third-party penalty may be objected to or contested in accordance with the usual procedures set out in the *Tax Administration Act* (CQLR, c. A-6.002).
- 52.** 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 will not make a decision regarding the third-party penalty until a final decision has been made regarding the other person's objection or contestation.
- 53.** In the case of a notice of assessment issued on the basis of information obtained from the CRA, the person does not have to file a notice of objection with Revenu Québec if they have already filed one with the CRA on the same points in dispute. In such cases, Revenu Québec complies with the decisions rendered by the federal authorities (including those concerning duties, interest and penalties, where applicable) after taking into account the particularities of Québec tax laws. The same applies if the person filed a notice of objection with Revenu Québec and later signed a conditional withdrawal of that notice.