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Advice is (Not) Cheap: Tax Advisor Found Negligent for Overlooking GAAR Risks

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Introduction

Tax advisors play a crucial role in navigating the complexities of the *Income Tax Act* (Canada)[1] (the "**ITA**") and its regulations by leveraging their expertise to implement tax planning strategies, maximize tax benefits and ensure compliance with the ITA for their clients. Aggressive tax planning can go wrong if not done properly, and can result in unintended tax consequences, potential penalties and interest. However, tax advisors who fail to properly advise their clients are also risking their own liability.

The Supreme Court of Canada in *Jean Coutu Group (PJC) Inc. v. Canada (Attorney General)*[2] held that, where an unintended tax consequence was realized, "the appropriate avenue [for taxpayers] to recoup their losses is not through the retroactive amendment of their agreement. Rather, if the mistakes are such a nature as to warrant it, taxpayers can bring a claim against their advisors, who generally have professional liability insurance, and try to prove that claim in the courts."[3]

The recent decision in *4258843 Canada Inc. c. KPMG*[4] ("***425 Canada***") demonstrates the severe consequences for tax advisors who are found liable for failing to properly and continually advise their clients on the recent developments in taxation relevant to their tax concerns.[5] *425 Canada* is also a stark warning to all tax advisors to consider the implications of the General Anti-Avoidance Rule ("**GAAR**") and to advise their clients of such implications.

Case Summary

The subject of the Applicants' action arose from a trust reorganization that resulted in an assessment by the Canada Revenue Agency (the "**CRA**") and Revenu

1 R.S.C., 1985, c. 1 (5th Supp).

2 2016 SCC 55.

3 *Jean Coutu Group (PJC) Inc. v. Canada (Attorney General)*, 2016 SCC 55 at para 43. See also: *Guindon v. Canada*, 2015 SCC 41 at para 1.

4 2024 QCCS 760 (CanLII) [*425 Canada*].

5 *425 Canada*, at para 149.

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Quebec for $3,934,090.25 CAD. In or around 2005, Louis Pilon secured a sub-distribution agreement with Genpharm Inc. ("**Genpharm**") and incorporated 4258843 Canada Inc. ("**Gennium**") to deal directly with Genpharm. To protect his assets, including the shares of Gennium and the significant dividends paid from Gennium, Mr. Pilon created Fiducie Familiale Louis Pilon ("**FFLP**") and a holding company 9134-1024 Quebec Inc. ("**9134 Quebec**").

In view of future acquisitions and a desire to further protect his assets, specifically two dividends of $1,000,000.00 declared by Gennium, Mr. Pilon sought tax advice from the Respondent, KPMG S.R.L./S.E.N.C.R.L. ("**KPMG**"). While asset protection could have been accomplished through FFLP, KPMG's tax plan to address Mr. Pilon's tax concerns included the creation of Fiducie Financiere Satoma (the "**Satoma Trust**"), a second family trust. Satoma Trust was subject to the anti-avoidance provision under subsection 75(2) of the ITA, colloquially referred to as the reversionary trust rule, which deems income earned on property held by a trust to be deemed income of the person who contributed the property to the trust. This resulted in a tax advantage to Mr. Pilon – dividends paid by Gennium to Satoma Trust were attributed to 9134 Quebec, which received the dividends as tax-free intercorporate dividends, rather than the Satoma Trust receiving a taxable dividend.

In or around 2011, the CRA assessed the Satoma Trust and concluded that Mr. Pilon obtained a tax benefit as a result of the reversionary trust rule.

Analysis

In an internal assessment, KPMG's GAAR Committee (the "**Committee**") reviewed a new proposed structure, similar to the one ultimately proposed to and implemented by Mr. Pilon. In its assessment, the Committee concluded that, if the facts of a client's situation are good, GAAR should not apply to this new structure, even given the application of subsection 75(2), where it can be demonstrated that a trust was put in place for reasons other than the tax advantage (i.e. asset protection). However, where it cannot be shown that the trust was put in place for reasons other than a tax advantage, it is more likely than not that the GAAR would apply.[6]

KPMG had advised Mr. Pilon in 2005 that the annual CRA Roundtable meeting would have ruled that his proposed tax plan would be compliant with the ITA. However, asset protection could have been achieved through FFLP – the creation of a new trust (i.e. the Satoma Trust) is what led to the tax benefit. The Committee's analysis should have reflected the increased GAAR risk based on the Committee's own assessment. KPMG had a duty to at least discuss the possibility of GAAR applying and the consequences of such application with Mr. Pilon.[7]

Additionally, the Supreme Court of Canada in *Canada Trustco Mortgage Co. v. Canada*[8] changed CRA's position on the application of the GAAR. The Court held that "[i]f at least one transaction in a series of transactions is an "avoidance transaction", then the tax benefit that results from the series may be denied under the GAAR… [and] is apparent from the wording of [section] 245(3) [of the ITA]."[9] The ramifications of the Supreme Court's position was discussed at the CRA's Roundtable in 2006 stating that intentional use of an anti-avoidance rule (i.e. reversionary trust rule) to gain a tax advantage (i.e. tax-free intercorporate dividends) would trigger the application of the GAAR.[10]

KPMG's duty to advise Mr. Pilon did not terminate in 2005. The law of taxation is constantly evolving and "even if KPMG's understanding of

6 *425 Canada*, at para 41.

7 *425 Canada*, at paras 121-122.

8 2005 SCC 54 [*Trustco*].

9 *Trustco*, at para 34.

10 *425 Canada*, at para 142.

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the GAAR in 2005 was reasonable, it had to know that its application was unforeseeable and notify the client in a more comprehensive way, and after a complete analysis."[11]

The CRA's view was that the Satoma Trust was structured to avoid tax on taxable dividends received, even if there was no distribution to its beneficiaries. Had it not been for KPMG's recommendation to create the Satoma Trust, "these sums could have remained in Mr. Pilon's existing corporate structure to fund acquisitions."[12] Overall, the Court found KPMG liable for the tax and interest paid by the Satoma Trust.

Conclusion

The decision in *425 Canada* is a warning to all tax advisors. Tax advisors must assess the likelihood and potential implications of the GAAR's application to tax plans, and have a duty to discuss the GAAR when advising their clients.[13] Additionally, the duty to properly advise clients in a timely and prudent manner extends to new developments in taxation relevant to their clients' situations.[14]

If you have any questions about the above information, please contract a member of the Gardiner Roberts LLP's experienced Tax and Estates Planning Group.

(This blog is provided for educational purposes only, and does not necessarily reflect the views of Gardiner Roberts LLP) .

11 *425 Canada*, at para 152.

12 *425 Canada*, at para 160.

13 *425 Canada*, at para 137.

14 *425 Canada*, at para 149.