Stewart: CRA Audit Project Gone Awry

The TCC's recent *Stewart* (2019 TCC 22) decision has hopefully put an end to an 18-year ordeal for two taxpayers dealing with a CRA project audit.

In 2000, an investment opportunity was presented to Alan and Cindy Stewart, husband and wife, which involved the development of a trailer park on a plot near Edmonton. Partici-pation required the acquisition of a mortgage interest on the land—an "eligible investment" for a self-directed RRSP.

The Stewarts owned and operated a small campsite and restaurant catering to construction workers. Alan was a welder with experience in the oil patch. The Stewarts were well aware of oil and gas development in the area of the proposed trailer park, and they believed it to be a sound business opportunity based on realistic financial projections. After consulting a lawyer who confirmed the investment's eligibility for an RRSP, the couple decided to participate and opened self-directed RRSPs; their combined RRSPs loaned $79,500 to a company controlled by the promoters and the loan was secured by mort-gage interests on the land.

In total, the promoters raised about $7 million from 119 in-vestors, including the Stewarts. The promoters had purchased the land (for $5,000) and properly registered $7 million in mortgages to the investors. The promoters did not develop the trailer park, but instead absconded with the money and transferred it overseas. The Stewarts and the other investors lost all monies invested; a class proceeding against the pro-moters was abandoned because recovery was unlikely.

Adding to the Stewarts' woes, the CRA said that the amounts stolen were included in their personal income. A 2004 reassess-ment of the Stewarts ensued and gross negligence penalties were imposed on them; the Stewarts objected. Some six years later, in 2010, the CRA confirmed the assessments. The Stewarts then appealed to the TCC and were put in abeyance until they came to trial in 2018.

The CRA offered three alternative grounds for including stolen RRSP amounts in Stewarts' income:

1) the Stewarts participated in a scheme to gain tax-free access to their RRSP funds through a collateral arrangement and thus received the funds as a taxable benefit (subsection 146(8));
2) the Stewarts' RRSPs acquired property for a consideration greater than FMV, so the difference was included in income (subsection 146(9)); or
3) the rights registered on title did not truly constitute mortgages and thus were not qualified investments, and consequently, the mortgages' FMV was included in income (subsection 146(10), predecessor of subsection 207.04(1)).

Concerning the primary ground, the CRA simply assumed that the Stewarts acted in concert with the promoters and had a collateral arrangement with them to obtain their RRSP funds back, but the CRA did not produce any evidence of such activity or arrangement. The court accepted the Stewarts' uncontradicted testimony that "[t]hey were innocent victims in what was in effect a con."

The court also rejected the other two CRA arguments, noting that the plot of land was duly acquired, mortgages on the land were properly registered, and, for an admittedly brief period, the developer had sufficient funds to pay back the loans secured by the mortgages: in sum, the mortgages were acquired for FMV. The fact that the funds were stolen rather than applied to their expected purpose of developing a trailer park did not change the nature of the mortgage interests or retroactively diminish their FMV on acquisition.

The Stewarts were arguably fortunate that the con artists who stole their RRSP savings were diligent in ensuring that all the fraud's legal formalities were properly implemented. Otherwise, one or both of the alternative grounds may have been upheld. In contrast, in *St. Arnaud* (2013 FCA 88), which also involved taxpayers scammed out of their RRSP savings, the taxpayers were found not liable for tax on the stolen amounts because the fraudsters *neglected* to perform the legal formalities to issue shares and thus undermined the CRA's assessing position, which was based exclusively on subsection 146(9). *Stewart* and *St. Arnaud* together invite discussion of whether it is appropriate from a fiscal policy standpoint to rest a taxpayer's tax liability on the defrauding parties' attention to detail.

A bigger question is why the case was litigated to judgment. The CRA assumed that the Stewarts knowingly participated in an RRSP strip—a scheme to access their RRSP funds tax-free—solely because the promoters had marketed RRSP strips to other taxpayers. There was no actual evidence of their intention to participate in an RRSP strip or that any RRSP strip actually occurred. Yet the CRA imposed tax and gross negligence penalties on the Stewarts, even though the CRA bore the burden of proof of the penalties.

The reason for the ultimate litigation may rest, in part, on the fact that the CRA spent the early 2000s in an audit project to combat RRSP and RRIF strip schemes. Many of these schemes involved purported investments in non-existent businesses or acquisitions of property at inflated prices, and they included collateral agreements to return some money. The audit project eventually resulted in reassessments of large numbers of disparate taxpayers. Appeals were stayed before the TCC—apparently including the Stewarts' case—to allow an orderly resolution through the use of lead cases. The CRA seemed unwilling or unable to treat the Stewarts' case as unique.

Audit projects play a valid role in ensuring taxpayers' consistent treatment, but they seem to risk missing the forest for the trees. The Stewarts' experience—having their retirement savings stolen and then spending almost two decades fighting reassessed taxes and gross negligence penalties—was not fair to them. One can only hope that *Stewart* promotes further CRA reflection on the management of audit projects and related litigation.

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