Please note that the following Policy Statement, although correct at the time of issue, may not have been updated to reflect any subsequent legislative changes.

GST/HST Policy Statement

P-237 The Acceptance Of A Due Diligence Defence For A Penalty Imposed Under Subsection 280(1) Of The E*xcise Tax Act* For Failure To Remit Or Pay An Amount When Required

Date of Issue

May 29, 2000

Subject

THE ACCEPTANCE OF A DUE DILIGENCE DEFENCE FOR A PENALTY IMPOSED UNDER SUBSECTION 280(1) OF THE *EXCISE TAX ACT* FOR FAILURE TO REMIT OR PAY AN AMOUNT WHEN REQUIRED

Legislative Reference(s)

Subsection 280(1) of the *Excise Tax Act*

National Coding System File Number(s)

11675-1

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September 29, 1998

Issue and Decision

This policy statement outlines the position of the Canada Customs and Revenue Agency (CCRA) on accepting a due diligence defence in respect of the penalty imposed under subsection 280(1) of the *Excise Tax Act* (ETA). This particular subsection provides that where a person fails to pay or remit an amount when required under Part IX of the ETA, the person shall pay on that amount a penalty equal to 6% per year and interest at the prescribed rate.

The imposition of a penalty pursuant to subsection 280(1) of the ETA does not specifically require that the intention to avoid tax exists before the penalty will be applied. The penalty is applied automatically under the provision as it provides that the person "shall pay" the penalty in respect of the failure.

The ETA does not specifically provide for a due diligence defence in the case of a penalty imposed under subsection 280(1) of the ETA. The CCRA accepts that in cases

where the CCRA determines that a person has exercised due diligence, the penalty is not exigible. In these cases, the penalty imposed under this provision will be cancelled by the CCRA. The acceptance of a due diligence defence is limited to the cancellation of the penalty under subsection 280(1) of the ETA and will not result in the cancellation of interest payable under this subsection.

The onus is on a person who claims to have been duly diligent to demonstrate to the CCRA that due diligence has been exercised. The CCRA cannot suggest criteria to make this determination as each one is based upon the particular facts of that case. However, an examination of the reasons for the late or insufficient remittance or payment will often assist the CCRA in determining whether a person has been duly diligent.

Making a Determination of Due Diligence

The CCRA's acceptance of a due diligence defence requires that a person make a sincere and demonstrable attempt that a reasonably prudent person in similar circumstances would be expected to make in order to comply with the requirement to pay or remit the amount when required. A person will be considered by the CCRA to have exercised due diligence where it can be clearly demonstrated that they have to the best of their ability taken reasonable care in ensuring that the correct amount was remitted or paid when required.

The CCRA may accept a due diligence defence in a situation where a person remits or pays an amount that is less than the amount actually owed where that amount was arrived at after having made an incorrect assumption based on genuine uncertainty regarding the application of the ETA. In addition, in a situation where a person is a recipient who fails to report and remit the tax on a self-assessment situation and this failure can be attributed to an incorrect assumption based on genuine uncertainty over the application of the ETA, a due diligence defence may be accepted by the CCRA. In either case, for a person to be duly diligent it must be clearly evident that despite making an incorrect assumption, all reasonable care has been taken to the best of their ability in ensuring that the correct amount was remitted or paid when required.

Limitations on the Application of Due Diligence

- Mathematical Errors/Inadequate Records: A due diligence defence may not be accepted by the CCRA where a person has made mathematical errors in the calculation of an amount, or where the CCRA has determined that the person has failed to keep adequate records.

- Inaccurate Third Party Advice: Where a person has relied solely on the advice of a third party which turns out to be technically inaccurate, the CCRA would generally not accept a due diligence defence. However, in a case where actions taken by a person's authorized representative lend support to a person's due diligence defence, these actions will be taken into consideration in determining whether a person has been duly diligent. Where appropriate, a person's level of sophistication in tax matters may be viewed as one contributing factor in the CCRA's determination as to whether due diligence has been exercised.

- Late Payment or Remittance: The CCRA would not generally accept a due diligence defence where the correct amount was paid or remitted after the due date. In particular, where the CCRA determines that a person has complied with the obligation to collect the correct amount as required but has failed to remit this amount when required, the person's due diligence defence would not be accepted. It is the CCRA's position that a person who has failed to take reasonable care to ensure that the correct amount was paid or remitted by its due date, has not exercised due diligence.

Eligibility For Relief Under the Fairness Guidelines

In cases where it has been determined that the penalty under subsection 280(1) is exigible, there may be extraordinary circumstances beyond a person's control which may have prevented them from complying with their obligations under the ETA. In these cases, the person may request that the CCRA waive or cancel the penalty and interest. For more information, please refer to *GST/HST Memorandum 500-3-2-1 Cancellation or Waiver of Penalty and Interest*.

Application of Due Diligence in "Wash Transaction" Situations:

In the case of a "wash transaction" where the penalty and interest is reduced to a penalty of 4% of the tax not collected and the CCRA has determined that the person has exercised due diligence, the remaining penalty will be cancelled. For more information on "wash transactions", please refer to *Technical Information Bulletin B-074 Guidelines for the Reduction of Penalty and Interest in Wash Transaction Situations* (replaced by GST/HST Memorandum 16.3.1, Reduction of Penalty and Interest in Wash Transaction Situations).

EXAMPLES

The examples that follow are not meant to set an absolute standard by which the CCRA will or will not accept a person's due diligence defence. This determination is to be made on a case by case basis according to the particular facts of each situation.

Example 1

Facts

1. A registrant files a GST/HST return when required and remits the net tax based upon the registrant's calculation.

2. The registrant makes a mathematical error on the return resulting in an insufficient remittance of net tax.

3. In addition to the unremitted amount of net tax, a penalty of 6% per year and interest at the prescribed rate is payable.

4. The registrant contends that the failure to remit was not deliberate and merely an error in the net tax calculation.

CCRA's Position

In this case, the CCRA will not accept a due diligence defence to cancel the penalty. Although the registrant made errors that are attributable neither to gross negligence nor to wilful intent, the making of unintentional errors is not in itself sufficient to warrant the acceptance of a due diligence defence. The defence of due diligence requires affirmative proof that reasonable care was exercised to ensure that errors were not made. The

payment or remittance of an insufficient amount was caused not as a result of any difficulty or lack of clarity with the legislation, but merely through an inaccurate calculation of the amount owing.

Example 2

Facts

1. A registrant concerned primarily with the day to day operations of the business hires an outside bookkeeping firm to account for the GST/HST and prepare the returns.

2. The registrant signs each completed return prepared by the bookkeeper, encloses the remittance as indicated on the return, and mails in the return by its due date.

3. Upon audit, the CCRA determines that errors have been made on several returns resulting in an additional assessment of net tax plus penalties and interest.

4. The bookkeeping firm does not provide any credible evidence to demonstrate that any particular action that they have taken on behalf of the registrant lends support to the registrant's due diligence defence.

CCRA's Position

Based on these facts, the registrant is not considered to have exercised due diligence in ensuring that the correct amount of net tax was remitted when required.

It is incumbent upon persons to familiarize themselves with their obligations under the ETA, and to ensure that those obligations are met. The registrant relied solely upon a bookkeeping firm which was unable to satisfy these obligations or to provide evidence that would support the registrant's due diligence defence.

In this case, the registrant's actions do not meet with the degree of "reasonable care" that must be taken in order for a due diligence defence to be accepted. The registrant remains obligated to remit the correct amount of net tax in spite of the fact that it was the bookkeepers who failed to determine the correct amount on behalf of the registrant.

Example 3

Facts

1. A registrant is the sole proprietor of a weight training equipment store located in Ontario. The store owner carries goods that are taxable at the rate of 7% and products that are zero rated (subject to tax at the rate of 0%).

2. The registrant begins to stock a chocolate flavoured "energy bar". The bar's ingredients consist of glucose, corn syrup, fructose, brown rice, whole oats, rice

crisps, hydrogenated soybean oil and carrageenan with a chocolate coating making up 5% of the total content.

3. The product literature describes the bar as "a delicious source of energy for breakfast, lunch, or anytime."

4. The registrant checks the other products in the store categorized as "meal replacements" and determines that tax is not charged in respect of these types of items.

5. The registrant asks the representative for the distributor of the bar whether or not it is subject to tax at the rate of 7%. The representative advises that the bar is not taxable since it is considered to be a "meal replacement" rather than "candy".

6. The registrant contacts a local CCRA office and asks a representative whether or not tax should be charged on "meal replacements". The representative, who bases the decision on the limited information provided, confirms that "meal replacements" are zero-rated.

7. The registrant reviews some CCRA publications but does not draw any conclusions from them as to the tax status of the bar.

8. The *Excise Tax Act* (ETA) is reviewed by the registrant. Under section 1 of Part III of Schedule VI to the ETA entitled "Basic Groceries", the registrant notices that supplies of food for human consumption are zero-rated with one of the exceptions being "confectionary that may be classed as candy".

9. For greater certainty, the registrant checks with an accountant who provides an opinion in writing that if the bar is a "meal replacement" then it is zero-rated and the registrant should not charge tax.

10. Based on all of the information obtained, the registrant believes that the bars are zero-rated and proceeds to sell them without charging tax.

11. During the course of an audit conducted by the CCRA the following year, the auditor determines that these "energy bars" are not "meal replacements" and are subject to tax at the rate of 7%.

12. The amounts that should have been collected on the sales of these bars plus a 6% penalty and interest at the prescribed rate are assessed by the CCRA.

13. The registrant makes a request to the CCRA to give consideration to cancelling the penalty based on a due diligence defence.

CCRA's Position

Based on the facts provided, the CCRA would accept the registrant's due diligence defence and cancel the penalty.

In making the determination whether or not tax should be charged on an item, the registrant exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances. The registrant researched product information, compared the product with what the registrant thought were similarly classified items, consulted CCRA publications and the ETA, and questioned the distributor of the product. Furthermore, the registrant sought formal advice from an accountant, and unknowingly provided incomplete information to obtain advice from CCRA officials.

Example 4

Facts

1. A registrant who is a sole proprietor completes a GST/HST return on which the amount of GST/HST collected is reported. It is the registrant's intention to mail the return with the correct remittance prior to the due date.

2. Prior to the due date of the return, there is a death in the registrant's immediate family whereby the registrant must assume the responsibilities as Executor to the Estate.

3. The registrant temporarily delegates the bookkeeping duties to a part-time sales employee.

4. The part-time sales employee mails in the return late and remits the correct amount.

5. The CCRA charges a penalty of 6% per year and interest at the prescribed rate since the registrant has failed to remit the amount when required.

6. The registrant contends that extraordinary circumstances beyond the registrant's control prevented the registrant from filing and remitting the correct amount on time.

CCRA's Position

Based on these facts, the CCRA would not accept the registrant's due diligence defence as the penalty was exigible in this case. However, the registrant may be eligible for cancellation or waiver of the penalty and interest under the fairness guidelines as published in *GST/HST Memorandum 500-3-2-1 Cancellation or Waiver of Penalty and Interest.*