



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, and for a Penalty Imposed Under Section 280.1 for Failure to File a Return When Required

Note: This policy statement replaces the version issued May 29, 2000 entitled *The Acceptance of a Due Diligence Defence for a Penalty Imposed Under Subsection 280(1) of the Excise Tax Act and for Failure to Remit or Pay an Amount when Required*.

Legislative references	Subsection 280(1), section 280.1 and subsection 281.1(2) of the <i>Excise Tax Act</i>
National coding system file number	11675-1
Effective dates	September 29, 1998, for penalty imposed under subsection 280(1), and April 1, 2007, for penalty imposed under section 280.1 of the <i>Excise Tax Act</i>

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.

Issue

This policy statement outlines the position of the Canada Revenue Agency (CRA) on accepting a due diligence defence in respect of the penalty imposed under subsection 280(1) of the *Excise Tax Act* (ETA). This 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.

This policy statement also outlines the CRA’s position on accepting a due diligence defence in respect of the penalty imposed under section 280.1 of the ETA. This section provides that where a person fails to file a return when required, the person is liable to a penalty imposed on the amount not remitted, or paid, on that return.

The penalty is equal to an amount calculated as:

- (a) 1% of the amount outstanding on the return, plus
- (b) 25% of the amount calculated in (a) times the number of complete months the return is overdue, to a maximum of 12 months.

This penalty applies in respect of:

- any return that is required to be filed on or after April 1, 2007, and
- any return that is required to be filed before that date, and that is not filed by March 31, 2007. In this case, the day on or before which the return is required to be filed is deemed to be March 31, 2007, but only for the purposes of calculating this penalty.

La version française de la présente publication est intitulée *L'acceptation d'un moyen de défense fondé sur la diligence raisonnable contre une pénalité imposée en application du paragraphe 280(1) ou de l'article 280.1 de la Loi sur la taxe d'accise, respectivement pour défaut de verser ou de payer un montant dans le délai prévu ou pour défaut de produire une déclaration dans le délai prévu*.



The penalty under section 280.1 for failing to file a return when required is assessed effective the later of the date the return was required to be filed, or April 1, 2007.

Decision

The ETA does not specifically provide for a due diligence defence in the case of penalties imposed under subsection 280(1) and section 280.1. The CRA accepts that in cases where the CRA determines that a person has exercised due diligence, these penalties are not exigible. In these cases, the penalties imposed under these provisions will be either not charged by the CRA, or if already charged, cancelled by the CRA. The acceptance of a due diligence defence is limited to the cancellation of the penalties under subsection 280(1) and section 280.1 and will not result in the cancellation of interest payable under section 280.

The onus is on the person who claims to have been duly diligent to demonstrate to the CRA that due diligence has been exercised. The CRA 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, or the late return, will often assist the CRA in determining whether a person has been duly diligent.

Discussion

Making a determination of due diligence

The CRA'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, or the requirement to file a return when required. Persons will be considered by the CRA 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, and/or that the return was filed by its due date.

The CRA 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 CRA. Also, the CRA may accept a due diligence defence where a person believed on reasonable grounds in a non-existent fact situation, which if it had existed, would have made the person's actions or omission innocent; that is, the person relied on a reasonable but erroneous belief in a fact situation. In any case, for a person to be duly diligent it must be clearly evident that despite making an incorrect assumption, or having an erroneous belief in a fact situation, all reasonable care has been taken to the best of the person's ability in ensuring that the correct amount was remitted or paid, and the return filed, when required.

Limitations on the application of due diligence

Mathematical errors/inadequate records

A due diligence defence may not be accepted by the CRA where a person has made mathematical errors in the calculation of an amount, or where the CRA 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 CRA 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 CRA's determination as to whether due diligence has been exercised.

Late payment or remittance

The CRA would not generally accept a due diligence defence where the correct amount was paid or remitted after the due date. In particular, where the CRA 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 CRA'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 taxpayer relief guidelines

In cases where it has been determined that the penalty under subsection 280(1) or the penalty under section 280.1 is exigible, there may be extraordinary circumstances beyond a person's control which may have prevented the person from complying with the person's obligations under the ETA. In these cases, the person may request that the CRA waive or cancel the penalty and interest. More information is available in GST/HST Memorandum 16.3, *Cancellation or Waiver of Penalties and/or Interest*.

Application of due diligence in "wash transaction" situations

In the case of a "wash transaction" where the 6% penalty and interest is reduced to a penalty of 4% of the tax not collected and the CRA has determined that the person has exercised due diligence, the remaining penalty will be cancelled. For more information on "wash transactions", please refer to GST/HST Memorandum 16.3.1, *Reduction of Penalty and Interest in Wash Transactions*.

Examples

The examples that follow are not meant to set an absolute standard by which the CRA 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.

Decision

In this case, the CRA will not accept a due diligence defence to cancel the penalty.

Rationale

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 CRA determines that errors have been made on several returns resulting in an additional assessment of net tax, plus the 6% penalty and interest under subsection 280(1).
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.

Decision

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.

Rationale

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. In July 2006, 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 6% and products that are zero-rated (subject to tax at the rate of 0%).
2. In September 2006, 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 6%. 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 CRA 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 CRA publications but does not draw any conclusions from them as to the tax status of the bar.

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8. The 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 “confectionery 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 CRA in January 2007, the auditor determines that these “energy bars” are not “meal replacements” and are subject to tax at the rate of 6%.
 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 CRA.
 13. The registrant makes a request to the CRA to give consideration to cancelling the penalty based on a due diligence defence.

Decision

Based on the facts provided, the CRA would accept the registrant’s due diligence defence and cancel the 6% penalty.

Rationale

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 CRA 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 CRA 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. 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 CRA 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.

Decision

Based on these facts, the CRA 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 of the penalty and interest under the taxpayer relief guidelines as explained in GST/HST Memorandum 16.3, *Cancellation or Waiver of Penalties and/or Interest*.

Example 5

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. 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 CRA charges a 1% penalty for failing to file the return by its due date, 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 the return and remitting the correct amount on time.

Decision

Based on these facts, the CRA 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 of the penalty and interest under the taxpayer relief guidelines as explained in GST/HST Memorandum 16.3, *Cancellation or Waiver of Penalties and/or Interest*.

Example 6

Facts

1. A registrant sole proprietor completes a GST/HST return on which the amount of GST/HST collected is reported.
2. The registrant submits the return and payment for the net tax owing at the registrant's financial institution prior to the due date of the return and net tax, and receives receipts for the same.
3. Due to a computer system problem at the financial institution, the return and payment are not processed until after the due date of the return. As a result, the CRA charges the registrant a 1% penalty for failing to file the return by its due date, and interest at the prescribed rate since the registrant has failed to remit the amount when required.
4. The registrant contends that the registrant was duly diligent in filing the return and remitting the net tax owing.

Decision

The CRA would accept the registrant's due diligence defence, and cancel the 1% penalty for failing to file the return by its due date.

Rationale

Based on these facts, the registrant had reasonable grounds to believe that the financial institution had submitted the return and remittance to the CRA on time. Therefore, the registrant acted with due diligence. However, the due diligence defence does not apply to the amount of interest assessed. The registrant may be eligible for cancellation of the interest under the taxpayer relief guidelines as explained in GST/HST Memorandum 16.3, *Cancellation or Waiver of Penalties and/or Interest*.