Tax Alert

Warning: Schemes that promote big tax losses or deductions are not worth the risk

The Canada Revenue Agency (CRA) is warning taxpayers about investing in schemes that provide inflated or unsubstantiated tax losses or deductions.

This type of business arrangement may be an "unregistered tax shelter," and participating in it puts taxpayers at risk of losing their entire investment, as well as any tax refunds they may receive as a result of making a claim on their tax return. Interest and penalties may apply.

If it sounds too good to be true, it probably is
Unregistered tax shelters can take many forms, but they typically involve buying a tax loss that is well in excess of the cash investment. People who promote these schemes will promise a large tax loss that can be claimed when investors file their income tax returns. This loss usually results in a tax refund, enabling the taxpayer to recover the initial cash they invested plus more. However, don't be fooled; simply buying a "tax loss" does not mean it is deductible.

In describing these schemes, the Canadian courts have used strong language such as "short-changed, if not swindled," in referring to the taxpayers who invested in these schemes.

A number of these schemes have already been reviewed by the CRA and claims made by investors have been disallowed. As schemes are identified, the CRA will continue to deny the losses claimed.

There are consequences
If the CRA determines that a scheme is an unregistered tax shelter, all tax deductions or credits claimed by taxpayers participating in the unregistered tax shelter must be denied. As well, the cash investment to participate in the unregistered tax shelter is not deductible since it was made solely to acquire tax losses. Reassessments will be issued and penalties will be considered. When an investor is found to have knowingly participated in an unregistered tax shelter to get tax benefits that he or she was not entitled to receive, penalties can amount to 50% of the taxes payable after reassessment.

There are also consequences for promoters. Penalties apply in situations where promoters should have registered and obtained a tax shelter number from the CRA. A registration number allows the CRA to identify a scheme and the taxpayers who have participated in the tax shelter, but it should not be interpreted to mean that investors are entitled to receive the proposed tax benefits. Promoters who do not register their tax shelters in an attempt to avoid audit action will face a penalty of 25% of the proceeds received from the investors for their participation in the tax shelter.

Get professional, independent advice
If you are thinking about investing in one of these arrangements, it is very important that you get independent financial and/or legal advice. Independent advice means advice from a tax professional that is not connected to the scheme or to the promoter.

Come to us before we come to you
If you have invested in one of these arrangements and you wish to correct your tax return, you can do so through the CRA's Voluntary Disclosures Program. If you make a full disclosure before any compliance or enforcement action is started, you may only have to pay the taxes owing plus interest, and you will not face penalties or prosecution in the courts. More information is available at **www.cra.gc.ca/voluntarydisclosures**.

Additional information on tax shelters is available on the CRA Web site:

- **Warning: Participating in tax shelter gifting arrangements is likely to result in a tax bill!** (August 2007)
- **Tax shelter donation arrangements** (November 2004)