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Calculating Damages in Tax Shelter Cases

A recent full page article in the Globe focused on CRA's crackdown on tax shelters.¹ If you are representing a taxpayer, or defending one of their advisors, in a dispute over tax shelters, it is important to keep in mind that the taxpayer's damages are not necessarily the amount of the reassessment. The quantum of the taxpayer's damages requires a separate calculation. Let me explain.

The Explanation

The traditional damages model is:

Actual Result: the position of the taxpayer, given their investment in the tax shelter;

Expected Result: the position of the taxpayer, had they been given proper advice, for example, not investing in the tax shelter; and

Damages: the difference between the Actual and Expected results.

What this means for cases involving tax shelters is:

Actual Result: the taxpayer invested in the tax shelter, took the deduction which reduced their tax otherwise payable (say Year 5). Subsequently they were reassessed, which increased their tax otherwise payable (say Year 10). The reassessment may include interest and penalties, and they may have paid professionals to assist in responding to the reassessment.

Expected Result: depends on the fact pattern in the case. In its simplest form, the taxpayer would not have invested in the tax shelter. Therefore, they would not have reduced their tax otherwise payable in Year 5, and would have avoided the increase in their tax otherwise payable in Year 10. In addition, they would have avoided the interest, penalties and professional fees.

Damages: the reduction in the taxpayer's tax payable in Year 5 is often roughly equal to the increase in the taxpayer's tax payable in Year 10. Therefore, there are often no damages at this stage in the calculation. The interest, penalties and professional fees are generally damages. Note that when pre-judgment interest is applied, there is often negative PJI from Year 5 to Year 10.

This analysis is presented in tabular form on the next page.

A Framework for Calculating Damages in Tax Shelter Cases

	Actual	Expected	Damages
Year 5	Reduction in tax otherwise payable (cash in)	No change to tax otherwise payable	Reduction in tax otherwise payable (cash in)
Year 10	Increase in tax otherwise payable (cash out)	No change to tax otherwise payable	Increase in tax otherwise payable (cash out)
	Interest, penalties, and professional fees (cash out)	None	Interest, penalties, and professional fees (cash out)
Net			Damages = Cash Out less Cash In

To get my help with your case involving damages, please contact me.

ⁱ Report on Business, Law Page, B8, “Noose tightens around donation tax schemes” May 23, 2012.

Peter Macaulay has over 20 years’ experience quantifying damages in commercial disputes; 9 years with Deloitte LLP, and over 10 years running his own practice. He has been designated as a specialist in Investigative and Forensic Accounting by the CICA and has testified on damages.
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