

Taxation of Pyramid Schemes - Sas Ansari

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Mazo v The Queen, [2016 TCC 232](#)

At issue was the income tax treatment of amounts received by a participant in a pyramid scheme that is not the developer or mastermind behind the scheme.

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FACTS

The Appellant was involved in a pyramid scheme, prohibited by the [Competition Act](#), called Business In Motion International Corporation (for a class action against corp see *Cuzzetto v. Business In Motion International Corporation et al*, [2014 FC 17](#)). The scheme was structured to create the appearance that participants were buying goods and services when all they were doing was buying a spot at the bottom of the pyramid.

NOTE: The Minister, despite a clear finding in the FC in the class action that this was a clear case of a pyramid scheme, maintained the position that the corporation was a multi-level marketing company that was selling goods and services (para 10). The Court stated that this position was clearly wrong and could "see no reason for the Minister to take such a position other than to artificially inflate the tax the Minister can assess" (para 10). However, the DoJ lawyer, Larissa Benham, handled the difficult position the Minister placed her in with professionalism (para 11).

ANALYSIS

The Court referred to previous decisions dealing with the tax treatment of fraudulent scheme [for a paper on this see [HERE](#)]. These cases show that income from a Ponzi scheme in the hands of a participant are income where the contractual rights are respected, but losses from a fraudulent scheme that was never a business are not non-capital losses (para 13).

Should profits from a pyramid scheme be treated the same way as Ponzi schemes?

The similarities between the two are (para 15):

- both are illegal;
- both rely on a continuous stream of new participants injecting new cash to sustain

withdrawals of a few at the top;

- both inevitably collapse under their own weight, leaving victims suffering losses; and
- Both present an illusion of people making money, with few extracting more than they put in.

The key differences between the two are (para 16):

- Participants in a Ponzi scheme believe they are making an investment, thereby generating profits, don't realize there is no investment; BUT
- Participants in a pyramid scheme may not realize the full nature of the scheme but are aware at some level that they are being paid using money that comes from those participants below them, such that is clear to everyone that without new people at the bottom there are no profits at the top.

The court held that "it would generally be more appropriate to characterize the income received by a participant in a Ponzi scheme whose contractual rights have been honoured as property income and the income received by a participant in a pyramid scheme whose contractual rights have been honoured as business income" (para 17).

In this case, the participants were being defrauded from the start by walking into a scheme that was doomed to failure but certain to put money in promoters' pockets (para 18). If participants' contractual rights were honoured - if they got what they bargained for - they are taxable on those amounts (para 18).

The Appellant was found not to have bargained for a pyramid scheme (para 19), but to join a sales organization that would result in commissions for recruiting sales people (para 20). As such, the payments, net expenses, were business income in the Appellant's hands.

The Court "reluctantly" agreed with the Minister's position in how to calculate profits, but stated that if another set of facts were to come before the courts, the method may well not be accepted. Rather, the income should be the amounts the participant actually extracted from the scheme (para 28).

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