

Private Corporation Announcements, October 16-20, 2017

After a flurry of submissions—more than 21,000—to the Department of Finance regarding the July 18, 2017 private corporation tax proposals, the minister of finance made a number of announcements between October 16 and 20. These announcements are summarized below.

- 1) *Proposals to limit access to the lifetime capital gains exemption.* The government announced that it was no longer moving forward with the measures that would have significantly limited access to the lifetime capital gains exemption. Does this mean that access to the exemption will be prevented vis-à-vis the new income-splitting proposals under section 120.4 if a taxable capital gain realized by a shareholder of a CCPC would fail the new reasonableness tests? At the recent Canadian Tax Foundation conference (“Tax Planning Using Private Corporations: Analysis and Discussion with Finance,” held in Ottawa on September 25, 2017), a Department of Finance representative appeared to offer some clarity on this issue: he said that if access to the capital gains exemption was available before July 18, 2017, the exemption should be available after that time. We await details, but ultimately the reversal on this aspect of the proposals was welcome.

- 2) *Proposals to prevent surplus stripping.* The broad scope of the surplus-stripping proposals came as a shock to many practitioners. When the government announced that it was no longer moving forward with the proposed changes to section 84.1 and new section 246.1, the news was welcomed.
- 3) *Proposals to limit income splitting.* These proposals represented the bulk of the draft legislation that accompanied the July 18, 2017 materials. The draft legislation was overly broad and complex and was likely not workable in practice. The government announced that it was moving forward with the income-splitting proposals but that it would work to reduce the compliance burden with respect to ensuring that the reasonableness standards were met. The government also announced that it would release further guidance later in the fall. At the time of writing (mid-December 2017), no further material had been released by the Department of Finance. This absence of information is disappointing, since taxpayers should be given ample time to review material and plan their affairs prior to the implementation date of January 1, 2018. In my opinion, the government should change the implementation date to January 1, 2019, rather than rush to implement tax policy that taxpayers and their advisers will not have sufficient time to absorb.
- 4) *Proposals on the tax treatment of corporate passive income.* The government announced that it was moving forward with the passive income proposals as generally outlined in the July 18, 2017 consultation documents (detailed draft legislation is to be released in the 2018 federal budget), with a few adjustments. First, all “past investments” and the income earned from those investments will be protected from the new regime (October 18, 2017). Second, a \$50,000 de minimis threshold was established for passive income per year for which “no tax increase” was announced. Third, the government will work with the venture capital community to ensure that the proposed changes will not negatively affect them. This aspect of the announcement was very short on details and has given rise to many questions. For example, how will capital gains be treated in the computation of the \$50,000 annual exclusion amount? How many new pools will have to be created in order to keep track of new regime versus old regime income? How will the grandfathering of existing assets work? Overall, the commitment to move forward on this aspect of the July 18, 2017 proposals

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is a disappointment for most tax practitioners. In particular, I worry about the behavioural consequences of affected taxpayers, since it is obvious to me that most of them will likely bend over backwards to avoid the very punishing aspects of these proposals if they ultimately become law.

- 5) *Reduction of the small business tax rate.* The previous federal government enacted scheduled reductions (to an eventual 9 percent rate) to the federal small business income tax rate on the first \$500,000 of active business income. In the 2016 budget, the current government cancelled the scheduled reductions, and the rate has remained at 10.5 percent. In October 2017, however, the government announced that reductions in the small business rate were being resurrected. The rates are now scheduled to change to 10 percent effective January 1, 2018 and 9 percent effective January 1, 2019. Increases to the tax rates of non-eligible dividends will also be adjusted. This announcement, in my opinion, represents politics at its worst. The July 18, 2017 proposals were never about the small business tax rates, and thus there is little doubt in my mind that the reduction was announced as a sweetener in return for some of the negative aspects of the proposals that remain.

The July 18, 2017 proposals were introduced, the government said, as measures necessary to improve the fairness of some of the rules relating to the taxation of private corporations. Between July and mid-October 2017, modified proposals were released. Significant concerns remain regarding the detail of the October version of the income-splitting amendments. Perhaps more importantly, many in the tax and business communities have expressed concern about the government's process in formulating and publishing serious tax policy proposals without significant private sector involvement. We should not adopt major tax policy changes in this manner. It is to be hoped that the government has listened to these concerns and will be open to private sector input in the policy formulation process when it considers future tax policy changes.

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The Pipeline Comes Back to Life (But for How Long?)

Editor's note: The following article was written before the December 13, 2017 announcement regarding additional proposed changes to the income-sprinkling rules, and should be read with that proviso in mind.

The July 18, 2017 proposals killed the pipeline, a common tax-planning strategy whereby corporate surplus could be extracted from a CCPC at personal capital gains rates rather than at dividend rates. The popularity of this strategy, both in a post mortem and an inter vivos context, has grown along with the increasing gap between the tax rate on dividends and the rate on taxable capital gains.

The mechanics of the pipeline are simple. Provided that the ACB of a company's shares owned by an individual or an estate was not created by a non-arm's-length person sheltering a gain by virtue of the capital gains exemption and/or V-day value (such ACB is known as "soft ACB"), the shares could then be transferred, without any tax consequences, to a corporation connected with the transferring individual or estate. The transferor would receive as consideration from the purchaser corporation high-PUC shares or a promissory note that could subsequently be redeemed or repaid tax-free over a period of time.

The July 18, 2017 proposals introduced new section 84.1, which changed the definition of "soft ACB" to include any ACB created on a non-arm's-length transaction regardless of whether any net tax had been paid by the transferor. This created the possibility that, in post mortem planning, the use of the pipeline would result in markedly more tax than a subsection 164(6) loss carryback plan would, assuming that the latter plan was available. Further, in intergenerational sales, the tax cost on such transfers would become so significant that an arm's-length sale would likely be the only viable option.

In the October 24, 2017 Fall Economic Statement, the government said that it would not be moving forward with sections 84.1 and 246.1 as proposed. It also said that any new versions of these sections would not be introduced with a July 18, 2017 effective date. At the Canadian Tax Foundation's 2017 annual conference, Finance indicated that it would be looking at the intergenerational and other technical issues raised by proposed section 84.1; however, its immediate concern would be developing detailed proposals for the taxation of a CCPC's passive income.

The immediate reaction from tax professionals was that post mortem pipelines that were either started or implemented before July 18, 2017 or that were being contemplated could now proceed under the old rules at an effective post mortem tax rate in the mid- to high 20 percent range. However, there remains the question of the status of inter vivos pipelines. Finance has indicated that its intention for post mortem

private corporation pipelines was that the tax rate should be the higher dividend rate, not the much lower capital gains rate. Therefore, tax practitioners are actively considering inter vivos pipelines as an alternative.

The idea is that the taxpayer creates a capital gain taxable at capital gains rates now, thereby avoiding potentially higher future dividend rates that would be borne by the estate. Depending on the province, the rate differential could be between 17 and 20 percent in 2018. In the worst-case scenario (one in which section 84.1 in its current form continues to be applicable), the taxpayer will have prepaid tax today at dividend rates as a consequence of the pipeline—that is, the same rate that would apply to dividends received in the future.

There are other technical issues to be considered in inter vivos pipeline planning. For the 2018 taxation year and onward, proposed subsection 120.4(4) (and in substance proposed subsection 120.4(5)) would convert twice the taxable capital gain created into a taxable ineligible dividend in the hands of a specified individual upon his or her disposition of shares to a non-arm's-length individual unless the taxable capital gain was an excluded amount. If subsections 120.4(4) and 120.4(5) are a concern, one should consider triggering the capital gain needed for the inter vivos pipeline in 2017, before the application date of the proposed legislation.

At the time of writing (before December 13, 2017), Finance has stated (at the Foundation's 2017 annual conference) only that it would be addressing the unintended consequences caused by subsections 120.4(4) and 120.4(5) in the proposed income-splitting rules; it was silent regarding the possible application of these provisions to the conversion of income into capital gains.

On the basis of the Crown's victory in *MacDonald* (2013 FCA 110), the CRA's stringent administrative guidelines on how to avoid the application of subsection 84(2) to deem the capital gain to be a dividend have to be considered when one is implementing an inter vivos pipeline. (See "Stopping the Pipeline—In Any Manner Whatever," *Tax for the Owner-Manager*, July 2013.)

The issues set out above do not represent an exhaustive list of the technical concerns that arise with respect to an inter vivos pipeline. Further, the opportunity to implement such a plan is limited: Finance will likely be addressing potential amendments to section 84.1 sometime in 2018. Practitioners will face much uncertainty in 2018 when dealing with section 84.1 and the other surviving elements of the July 18, 2017 proposals.

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Assignment of Small Business Limit Creates Filing Headaches

Many CCPCs could be affected by practical issues in the specified corporate income rules under the small business deduction (SBD) regime. Specifically, issues may arise when an entity wants to assign a business limit—including a business limit with incomplete information—to another corporation that has a different year-end. This assignment could result in an excessive business limit being assigned.

Finance announced changes to amend the SBD regime in the 2016 federal budget, which, among other things, introduced the specified corporate income rules and amendments to the specified partnership income rules. These changes apply to taxation years beginning after March 21, 2016, subject to certain transitional rules.

Under the specified corporate income rules in section 125, certain active business income of a CCPC (Serviceco) that is generated by providing property or services to certain non-arm's-length persons is not eligible for the SBD ("excluded corporate income"). However, the excluded corporate income may still be eligible for the SBD if another CCPC (the assignor) that receives property or services from Serviceco assigns a portion of its business limit to Serviceco.

The maximum amount that the assignor can assign to Serviceco is generally Serviceco's excluded corporate income earned from the assignor, to the extent that the amount is not otherwise deductible by the assignor in computing its own excluded corporate income under paragraph 125(3.2)(c). However, some practical issues appear to arise when an entity assigns a business limit to another corporation that has a different year-end.

Assume that Mr. A owns 100 percent of a CCPC (Serviceco). Mr. A's spouse, Ms. A, owns 100 percent of another CCPC (the assignor). Serviceco has a December 31 taxation year-end, and the assignor has a March 31 taxation year-end. Serviceco provides services to the assignor during its 2017 taxation year. Serviceco's service income is subject to the specified corporate income rules.

So that Serviceco can claim the SBD on its "service income" in 2017, the assignor might assign a portion of its business limit in its corporate tax return for its taxation year ending on March 31, 2017. However, the assignor's year-end occurs well before Serviceco's year-end on December 31, 2017, and the assignor's filing deadline is September 30, 2017. When the assignor files its corporate tax return, it will not know exactly how much service income Serviceco will earn from the assignor by the December 31, 2017 year-end. This will make it difficult for the assignor to ensure that it assigns a sufficient portion of its business limit to Serviceco.

The assignor may consider amending its corporate tax return once December 31, 2017 has passed and Serviceco can

accurately determine its service income for its 2017 taxation year. However, if the assignor does this, it will bear an undue administrative burden every year, just so that another company, Serviceco, can claim the SBD. Furthermore, Serviceco may have to wait until the assignor actually amends its tax return to ensure that the correct amount is assigned, which could delay Serviceco's filing of its own tax return. As a result of incomplete information (due to the uncertainty of Serviceco's service income), the assignor might choose to assign an excessive portion of its business limit to Serviceco when it files its March 31, 2017 tax return. But under the assignment rules, the assignor can assign only up to a maximum amount. A practical issue thus arises: the assignment may be considered invalid, and the result could be that none of Serviceco's service income will be eligible for the SBD. It is unclear whether making an excessive business limit assignment will void the assignment in its entirety under the specified corporate income rules.

This issue could also arise if Serviceco's service income is later reassessed by the CRA and found to be a lower amount, which creates an excessive assignment by the assignor. This outcome will pose a problem if the assignor's relevant tax return is statute-barred (and if it cannot assign a new portion of its business limit to Serviceco).

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GAAR: Relevance of Subsequent Amendments and Alternative Transactions

In *Univar Holdco Canada ULC v. Canada* (2017 FCA 207), the FCA overturned the TCC's decision (2016 TCC 159). The judgment contained several important practical points in respect of the analysis and application of GAAR, and taxpayers are likely to rely on it in the future.

The taxpayer acquired a multinational group of companies. Immediately following the acquisition, a restructuring was undertaken to increase the amount of retained earnings that the taxpayer could take out of Canada without incurring part XIII tax. Section 212.1 contains a specific anti-avoidance rule that ordinarily would prevent this type of tax-free extraction of Canadian surplus, but subsection 212.1(4) provides an exception to the rule in certain circumstances. The post-acquisition restructuring was undertaken to allow the taxpayer to fall within this exception.

Although the taxpayer satisfied the technical conditions for the exception in subsection 212.1(4) to apply, the Crown argued that there was abusive tax avoidance because the specific anti-avoidance rule in subsection 212.1(1) was frustrated by the taxpayer's post-acquisition restructuring. There was no

dispute about the first two elements of GAAR: the taxpayer conceded that there was a tax benefit and an avoidance transaction. The sole issue was whether there was a misuse or abuse of section 212.1.

The TCC's Decision

The TCC held that GAAR applied to the transaction. Despite what appeared to be limited information about Parliament's intention in enacting section 212.1, the court concluded that the provision's purpose was to prevent non-resident shareholders from reorganizing their Canadian-resident corporations to convert dividend distributions otherwise subject to withholding tax under part XIII into tax-free capital gains. In the TCC's view, accepting the taxpayer's position would have allowed any non-resident shareholder to reorganize its corporate structure to ensure that subsection 212.1(1) never applied by "artificially complying" with the text of subsection 212.1(4). Although the taxpayer noted that a common alternative structure could have achieved an equivalent tax result, the TCC dismissed the relevance of that fact, stating simply that "in tax law, form matters."

The TCC relied on prospective amendments and the Supplementary Information to Budget 2016 announced in March 2016, which were published after the hearing of the matter. The Supplementary Information stated that the government was currently challenging the perceived misuse of subsection 212.1(4) and that the proposed measures were intended to "promote certainty and clarify the intended scope of the existing exception." As a result, subsection 212.1(4) would no longer apply to transactions like those undertaken by the taxpayer. The taxpayer was not given an opportunity to address the prospective amendment or the Supplementary Information following trial.

The TCC pointed to the FCA's decision in *Water's Edge Village Estates (Phase II) Ltd. v. Canada* (2002 FCA 291) as support for the proposition that subsequent amendments are relevant to determining purpose in a GAAR analysis. Understandably, reliance on prospective amendments and self-serving commentary in the Supplementary Information caused significant concern for Canadian tax professionals because it appeared to permit the government to make retroactive amendments to the Act.

The FCA's Decision

The FCA allowed the appeal and held that GAAR did not apply. In coming to the decision that there was no abusive tax avoidance, the court reiterated the principle in *Copthorne Holdings Ltd. v. Canada* (2011 SCC 63)—the minister must clearly demonstrate that the transaction is an abuse of the Act—and noted that in this case, the burden was not met. In the FCA's view, the transactions undertaken by the taxpayer did not frustrate the purpose of section 212.1 because the purpose could not

be demonstrated to be “to prevent the removal from Canada, by an arm’s length purchaser of a Canadian corporation, of any surplus that such Canadian corporation had accumulated prior to the acquisition of control.”

The FCA clarified its decision in *Water’s Edge* and explained that *Water’s Edge* did not support the proposition that subsequent amendments to the Act would necessarily reinforce or confirm that transactions caught by such amendments would be considered abusive. Specifically, in *Water’s Edge*, the conclusion that the result in that case was contrary to the scheme of the Act was reached *before* there was any discussion of the later amendments. It is notable that in *Water’s Edge* the amendments were an immediate response by Parliament to the tax planning in question, whereas the prospective amendments to section 212.1 would be enacted almost a decade after the transactions at issue took place and almost 40 years after section 212.1 was first introduced.

The FCA also confirmed that the taxpayer’s argument with respect to alternative structures that have equivalent tax results is a relevant factor in the GAAR analysis:

In my view, these alternative transactions are a relevant factor in determining whether or not there has been an abuse of the provisions of the [Act]. If the taxpayer can illustrate that there are other transactions that could have achieved the same result without triggering any tax, then, in my view, this would be a relevant consideration in determining whether or not the avoidance transaction is abusive.

This decision could prove to be a powerful tool for taxpayers that challenge GAAR in the future, since it will be difficult to see how the Act is being abused if the taxpayer can show that the Act permits the same tax result of a transaction that takes a different form. Although the TCC seemed to emphasize the form of the transaction, it might be suggested instead that the opposite is true for GAAR, which can apply regardless of the “form” used.

Ultimately, the decision of the FCA in *Univar* comes as a welcome addition to the body of case law on the application of GAAR. If the TCC’s decision had been upheld, GAAR and prospective amendments could be married with retroactive effect, which would have created considerable uncertainty. It remains to be seen how taxpayers will make use of this new comparative tool of alternative transactions and how much weight the courts will give this tool in future judgments; for now, however, the case provides much-needed clarification of the limitation on the impact of future legislative amendments in a GAAR analysis.

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Professional Negligence: The Discoverability of Liability Claims in Tax Cases

In *Presidential MSH Corporation v. Marr Foster & Co. LLP* (2017 ONCA 325), the issue was whether a claim of negligence made by MSH against its individual accountant and his firm (collectively, “the accountants”) was statute-barred.

The facts in the case are relatively simple. The events were set in motion when MSH’s accountants filed MSH’s corporate tax returns after the due date. As a result, the CRA denied income tax credits that would have been available if the tax returns had been filed on time. Consequently, MSH suffered damages of approximately \$500,000 in unpaid taxes, interest, and penalties.

MSH received the CRA’s notices of assessment disallowing the claimed credits on April 12, 2010. Upon receipt of the notices of assessment, a principal of MSH contacted the accountants to seek advice. In its decision, the Court of Appeal for Ontario (ONCA) stated that the motion judge had inferred that the accountants had advised an MSH principal to retain a tax lawyer to determine how to solve the problem, but they did not advise MSH to obtain legal advice about a professional negligence claim against the accountants.

MSH retained a tax lawyer on April 15, 2010, but there was no discussion of possible action against the accountants. The tax lawyer filed a notice of objection and an application for discretionary relief. The accountant who had made the original omission assisted the tax lawyer in preparing these appeals, until at least November 2011. In a letter dated May 16, 2011, the CRA advised MSH that the assessments would be confirmed; on July 7, 2011, it confirmed them.

The motion judge said that as late as July 2011 there was still a reasonable chance that the application for discretionary relief could mitigate some or all of MSH’s loss. On August 1, 2012, the statement of claim was issued against the accountants. That date was more than two years after the initial denial of the tax credits by the CRA but was within two years of the CRA’s refusal to change the assessments in response to the notice of objection. Ontario’s Limitations Act, 2002 provides for a basic limitation provision, which was applicable in this case. Specifically, the Limitations Act provides that a proceeding cannot be commenced in respect of a claim after the second anniversary of the day on which the claim was discovered.

It further provides in section 5(1) as follows:

- (1) A claim is discovered on the earlier of,
 - (a) the day on which the person with the claim first knew,
 - (i) that the injury, loss or damages had occurred,
 - (ii) that the injury, loss or damage was caused by or contributed to by an act or omission,

- (iii) that the act or omission was that of the person against whom the claim is made, and
- (iv) that, having regard to the nature of the injury, loss or damage, a proceeding would be an appropriate means to seek to remedy it. . . .

Pardu JA, writing unanimously for the court, began the analysis by reviewing section 5(1) of the Limitations Act and the decision in *407 ETR Concession Company Limited v. Day* (2016 ONCA 709), in which Laskin JA held that the appropriateness test in section 5(1)(a)(iv) of the Limitations Act “can have the effect . . . of postponing the start date of the two-year limitation period beyond the date when a plaintiff knows it has incurred a loss because of the defendant’s actions.” Laskin JA further held that whether an action is appropriate depends on the specific factual or statutory setting of each individual case.

Pardu JA then reviewed the existing case law to determine whether it was appropriate for MSH to commence its action against the accountants while the CRA appeal was still being pursued. She paid particular attention to *Brown v. Baum* (2016 ONCA 325), which she cited as a leading example of the suspension of a limitation period. In *Brown*, the plaintiff suffered severe complications from surgery performed by a medical doctor. The doctor performed a series of subsequent surgeries in an attempt to improve the outcome of the initial surgery. The patient brought an action against the doctor in June 2012, three years after the initial surgery but within two years of the last ameliorative surgery. The motion judge held that the limitation period did not commence until June 2010, when the last ameliorative surgery was performed, and that the patient’s proceeding was not appropriate while treatment continued. The ONCA upheld the decision and stated that it would not have been appropriate for the patient to sue the doctor while he was trying to fix the complications that arose in the original surgery because “he might well have been successful in correcting the complications and improving the outcome of the original surgery.” Pardu JA also reviewed the decision in *Chelli-Greco v. Rizk* (2016 ONCA 489), which dealt with a dentist and a similar series of ameliorative operations.

On the basis of this case law, Pardu JA held that legal action may be inappropriate in cases where a plaintiff is relying on the superior knowledge and expertise of a defendant, which often, although not exclusively, occurs in a professional relationship. That is, the limitation period may not begin to run if a professional attempts to remedy an action leading to a possible negligence claim because it may not be appropriate to commence the claim while the ameliorative work is being done. Pardu JA also reviewed a second line of cases relating to discoverability in section 5(1)(a)(iv) of the Limitations Act involving the pursuit of other processes that have the potential to resolve the dispute between the parties and eliminate the plaintiff’s loss.

Applying the case law to the facts at hand, the court held that the motion judge had erred in holding that MSH knew or ought to have known that its proceeding was appropriate as early as April 2010, when it received the CRA’s notices of assessment disallowing the tax credits. The court held that proceeding was not appropriate, and the plaintiff’s underlying claim was not discovered, until May 2011, when the CRA responded to the appellant’s notice of objection and advised that it intended to confirm its initial assessments.

The court concluded that the actions of the accountants in attempting to resolve the dispute were significant; it noted that if the CRA appeal process had been successful, MSH’s loss would have been substantially eliminated. The court held that it would not have been appropriate for MSH to commence a proceeding against the accountants until the ameliorative efforts had concluded. Accordingly, the court allowed the appeal and set aside the judgment of the motion judge.

This case is of interest to tax practitioners in Ontario who deal with situations in which ameliorative efforts may mitigate or eliminate a possible claim in negligence. Practitioners should be aware that participating in ameliorative efforts may delay the commencement of the limitation period applicable to the negligence claim.

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RRSP Overcontributions: Unreasonably Harsh and Disproportionate Penalties

The Act is now so complicated that an understanding of its provisions is beyond the comprehension of even the most well-intentioned average taxpayer. What are the CRA and the courts to do when innocent taxpayers make mistakes attracting penalties and interest because they did not understand the technical requirements of the Act? In the CRA’s case, the minister has the discretion to waive the penalties and interest in appropriate cases. If the minister refuses to do so, taxpayers may ask a court to review the minister’s decision. That is all well and good. But what if the CRA and the courts take the position that taxpayers are presumed to know the law and must accept the consequences—and it turns out that not only do they not know the law, they rely in good faith on advice from a third party that is presumed to know the law? *Connolly v. Canada (National Revenue)* (2017 FC 1006) is an example of such a situation. The case is perhaps most remarkable for the way an FC judge decided a judicial review application on behalf of the taxpayer after the TCC upheld the minister’s assessment of interest and penalties and her refusal to exercise her subsection 204.1(4) discretion to waive them when asked to do so.

Mr. Connolly, the taxpayer, made RRSP overcontributions totalling some \$45,000 from 2005 through 2008, prompted by notations in his notices of assessment for 2003 and 2004 indicating that he had “unused RRSP contributions” to be carried forward. In fact, he did not have the necessary contribution room due to pension contributions made through his employer for those years. The language in the assessment notices was in the usual form and included the standard warning that if the unused contribution room exceeded his RRSP deduction limit, he might be subject to a penalty tax. He used the services of an accountant to prepare the returns, but the accountant did not advise him of the potential overcontributions. The CRA subsequently identified the overcontributions and advised the taxpayer to take steps to rectify the matter. The accountant was involved in this process, which extended over several years. The length of time was attributable to the accountant’s delays in coming to grips with the issue. The upshot was that deadlines for filing the appropriate overcontribution forms—and obtaining a corresponding deduction for the inclusion in income of the overcontributions—were missed. The CRA assessed Mr. Connolly for penalties and interest for his 2010 year. These amounts totalled \$57,831.42 as of August 29, 2016.

The issues came before the TCC by way of a notice of appeal from the CRA’s reassessment of Mr. Connolly’s 2010 year. In that year, he withdrew the overcontributions, included them in income, and claimed an offsetting deduction under subsection 146(8.2). The CRA denied the deduction on the basis that he had not taken the appropriate steps to support the deduction on a timely basis. The TCC allowed the appeal in respect of the amounts attributable to the 2003 year, but dismissed it as it related to the 2004 carryforward. The court said:

The applicant made the Over-Contributions without recognizing that he did not know the complex rules of RRSP contribution limits and related issues, which an average taxpayer could not likely ever know.

However, the court recommended that Mr. Connolly apply for relief under subsection 204.1(4), which he did. That subsection provides, in part, that the minister may waive the penalty tax on an overcontribution if the taxpayer establishes to the satisfaction of the minister that the amount was overcontributed “as a consequence of reasonable error.”

The minister reconsidered the matter, and on November 30, 2016 denied the request for relief, essentially on two grounds. First, the taxpayer was presumed to know the requirements of the law and was not entitled to relief on the basis that he did not. Second, the fact that the delay in filing the overcontribution forms was attributable to a third party did not absolve the taxpayer. The law is clear that he, not the third party, is responsible for complying with the requirements of the Act. The taxpayer then applied to the FC for a fairness review.

The FC felt constrained by the existing jurisprudence to dismiss the application, but it was obviously sympathetic to the

taxpayer’s plight. On the basis of a line of authority originating with a decision of the SCC in a criminal case (*R v. MacDougall*, 1982 CanLII 212 (SCC)), the FC felt that it could not interpret subsection 204.1(4) in a manner that would justify giving relief. Very briefly, that line of authority holds that ignorance of the law is not a defence in a criminal case, and this reasoning has been imported into the tax jurisprudence in subsequent cases. But the FC said, “In rejecting the Applicant’s arguments, the Court does not wish to leave the impression that the outcome sits well with it, or that it does not share considerable empathy for the Applicant’s situation.” The FC observed that “no court sets out to encourage an appeal of its decision,” but then went on, in effect, to do just that, by setting out the submissions that Mr. Connolly might make if he chose to appeal.

I will not summarize the suggested arguments here. They are well thought out and might (to my mind, should) be persuasive at the Court of Appeal level. The technical legal analysis is not the purpose of this article. Rather, it is to question why this matter wound up in court at all. As noted above, subsection 204.1(4) gives the minister discretion to provide relief when the excess contributions arose as “a consequence of reasonable error.” The minister consistently refuses to exercise her discretion if the error is attributable to ignorance of the law or reliance on a third party, and courts have generally upheld the minister’s refusal to act in these circumstances. But I think it is time that we questioned whether the minister is acting within the object and spirit of subsection 204.1(4). Excluding honest ignorance of the law from the discussion of a reasonable excuse certainly makes life easier for the minister. If the law were clear and accessible to a reasonable person, it would also make common sense. But to say that we all are presumed to understand the implications of tax rules drafted in a language known, if at all, to a relatively small (and expensive) group of specialized advisers is the antithesis of common sense. Why not take Parliament’s intention in enacting subsection 204.1(4) at face value and apply it to bring some sense of fairness into the equation? I know the argument against doing so: the CRA will be overwhelmed with requests and will find it impossible to determine which requests are based on honest ignorance and which are prompted by improper motives. But it should be part of the administrator’s job to do just that. It is ironic that the “ignorance is no excuse” principle derives from the criminal law. There, at least, the accused is entitled to a presumption of innocence when charged.

Why can’t we take a similar view when dealing with the factual circumstances of an individual’s tax case? The CRA’s mantra in discretion cases is that the taxpayer bears responsibility for the ignorance or negligence of a professional adviser: in other words, “If the adviser messes things up, then sue the adviser; don’t ask us to fix the problem.” Is this really what Parliament intended in providing for discretionary relief? In the real world, an action for professional negligence just

isn't worth the time, expense, and emotional energy involved unless the stakes are high and the negligent adviser has the means to pay damages if the action succeeds. I can't escape the feeling that the CRA's "don't ask us for help when the adviser is at fault" refusal is a cop-out, too. Yes, using it as a reason reduces significantly the number of cases in which the minister will actually have to look at all the circumstances and ask: "Did Parliament really intend that this taxpayer in these circumstances should have no access to discretionary relief?" But isn't that exactly why provisions like subsection 204.1(4) are in the Act in the first place?

I don't know whether Mr. Connolly will take an appeal to the FCA. But I hope that he does, and I hope that the FCA seizes the chance to improve the minister's approach to discretionary provisions like subsection 204.1(4).

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Friends Don't Let Friends Get Assessed Under Section 160

Overview of Section 160

If certain conditions are satisfied, section 160 of the Act allows the minister to collect the tax debt of a taxpayer from another person. The provision generally is intended to prevent taxpayers from thwarting the minister's efforts to collect a debt by gratuitously transferring their property. For section 160 to apply, the following conditions must be met:

- 1) the transferor must be liable to pay an amount under the Act in respect of a particular taxation year;
- 2) there must be a transfer of property during that year or a subsequent year;
- 3) the transferee must be the transferor's spouse or common-law partner, a minor, or a person with whom the transferor was not dealing at arm's length; and
- 4) the FMV of the property transferred must exceed the FMV of the consideration given by the transferee.

When these conditions are satisfied, a transferee becomes jointly and severally liable with a transferor for the tax debt to the extent of the difference between the FMV of the transferred property and the consideration received by a transferor for the property.

Because of its broad application, section 160 can have severely detrimental effects on taxpayers. It is important to note that the minister is not required to assess culpable transferees. That is, there is no requirement that a transferor or transferee have any intention of avoiding a tax debt, or even have knowledge of the tax debt.

Several authors have written on the breadth of section 160 as a collection mechanism. The provision has also been subject

to significant criticism for its unfairness and for its potential to give rise to double tax. Instead of adding to this discussion, in this article I describe situations in which a taxpayer may unintentionally cause a friend, spouse, or minor to become responsible for the taxpayer's tax burden.

Leave Your Spouse Out of It

If the conditions set out in subsection 160(1) are met, the only exceptions that can save a transferee from being jointly and severally liable for a transferor's tax debt are limited transfers in the matrimonial context. Subsection 160(4) precludes the application of subsection 160(1) when a transfer is made pursuant to "a decree, order or judgment of a competent tribunal or pursuant to a written separation agreement" if at the time of the transfer the spouses were "separated and living apart." For the purposes of paragraph 160(1)(e), the FMV of property transferred to the spouse is deemed to be nil. This exception is limited and does not apply to assets transferred prior to the separation.

On the basis of the decision in *Yates v. Canada* (2009 FCA 50), when a tax debtor transfers an amount to his or her spouse on the condition that the spouse pay for family expenses, subsection 160(1) may apply. Inherent in *Yates* is the conclusion that the assumption of household liabilities is not valid consideration. Thus, the limited exception in subsection 160(4) may give spouses an incentive to divorce if one spouse has a large tax debt and valuable assets (provided that the parties can establish a bona fide breakdown of their marriage). Alternatively, if a transferee spouse has a right to property under a constructive trust, or even the right to apply to a court of equity for such a declaration, giving up this right may be valid consideration (*Darte v. The Queen*, 2008 TCC 66).

The Transferor's Bankruptcy Does Not Help the Transferee

A transferee's joint and several liability for the tax debt of a transferor remains intact even when a transferor is discharged from bankruptcy. Although the transferor is no longer liable for its own tax debt, the discharge from bankruptcy does not similarly benefit the transferee. Arguably, this puts the transferee in a worse position because the transferee is solely liable for the amount assessed under section 160.

In *Canada v. Heavyside* (1996 CanLII 3932 (FCA)), the respondent was assessed under section 160 for the tax debt of her husband following the receipt of her husband's 50 percent ownership interest in property for which she paid no consideration. The husband subsequently made an assignment in bankruptcy and was later discharged. Following the discharge, the husband no longer owed an amount to the minister. The order of discharge extinguished only the husband's liability to pay the debt, not the debt itself. Given this distinction, the transferee remained liable to pay an amount to the minister.

Don't Transfer Amounts That Are Exempt from Seizure

Transferred property that is initially exempt from seizure in the hands of a transferor can still result in a section 160 assessment. Under section 160, all of a transferee's assets are within the minister's reach; their previous character in the hands of a transferor is not relevant. In *Bernier v. The Queen* (2010 TCC 85), for example, a tax debtor received workers' compensation payments that were exempt from seizure under Quebec law. The tax debtor transferred the full amount of the workers' compensation payments to his spouse for no consideration. Section 160 was held to apply to the amounts, and the spouse was liable for her husband's tax debt.

Avoid Shareholder Benefits and Think Twice Before Declaring a Dividend

Corporate tax debtors should proceed cautiously when transferring amounts to non-arm's-length shareholders. Subsection 160(1) can apply to shareholder benefits, shareholder loans, and dividends, notwithstanding that the amounts were already included in the shareholder's income. Moreover, a shareholder is not entitled to a deduction if the shareholder makes a payment in satisfaction of the transferor's tax liability. Thus, a shareholder may pay tax on the value of the corporate transfer and be subject to the minister's seizing the full amount of the transferred funds (before tax).

In *Bleau v. The Queen* (2006 TCC 36), the court noted this deficiency and recommended that administrative arrangements be made to overcome the abusive effects that result when both sections 15 and 160 apply. The minister has not indicated whether she will be open to such arrangements.

Timing Is Everything

A transferor is not required to have knowledge of the tax debt at the time of the transfer. Section 160 may apply if the liability arises at any time during or before the year in which the transfer is made. Because a transferor may not be assessed in respect of a tax debt until years later, gratuitous transfers made prior to the date on which the assessment is issued could be at risk.

Don't Take Back the Transferred Property

In some cases, a transferee attempts to remedy a section 160 situation by returning transferred property to a transferor. Although that may seem like a good idea at the time, there is likely no benefit in a transferee's returning the property unless the transfer was clearly a loan. In fact, the situation is made worse because subsection 160(1) should continue to apply and the transferee will not be able to utilize the value of the transferred property to discharge its liability to the minister. Absent circumstances in which the gift can be disclaimed, this is a game of hot potato that benefits no one.

In the Future

Because it is undoubtedly important to prevent taxpayers from escaping their tax liabilities, taxpayers may be subject to section 160's overreaching effects. Thus, they should proceed cautiously in order to avoid subjecting friends and family to the punitive consequences of section 160. They should think twice before transferring property for less than FMV, even if the transferor is not attempting to avoid paying a tax debt by making the transfer.

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Tax Appeal Deadlines: Traps and Tips

Benjamin Franklin once wrote that "time is money." When it comes to appealing a CRA assessment under the ETA, this maxim is literally true. If the specified deadlines are not met, a registrant may find itself legally prohibited from challenging the CRA's reassessment, even if the assessment is clearly wrong.

Given the tight timelines in effect under the ETA, it is not uncommon for tax appeal deadlines to seemingly come and go quickly. Fortunately, sometimes an extension may be granted even if it appears that a tax appeal deadline has passed. Alternatively, and on rare occasions, a technical argument can be made that because of procedural missteps by the CRA, the tax appeal deadline has not actually been missed.

Notice of Objection

The first step to challenging a CRA notice of assessment or reassessment is to file a notice of objection within 90 days of the day on which the notice of assessment is sent (not three months—a frequent mistake). The 90-day calculation begins on the day that the notice of assessment was *sent*. The date of *receipt* has no bearing on the calculation, and the FCA confirmed in *Canada v. Shafer* (2000 CanLII 16118) that there is no requirement that a taxpayer ever actually receive the notice of assessment.

If the registrant is a specified person (defined in ETA subsection 301(1)), it must meet specific content requirements for the notice of objection (ETA subsection 301(1.2)). Failing to meet these requirements can limit or seriously hamper the registrant's right of appeal to the TCC. Accordingly, we recommend that professional advice be obtained every time a notice of objection is prepared.

Notice of Appeal to TCC

A registrant cannot file a notice of appeal unless it has previously filed a objection. If an objection has been filed with the minister, an appeal can be filed with the TCC after either

- 1) the minister has confirmed the assessment or has reassessed, or
- 2) 180 days have elapsed after the filing of the objection and the minister has not notified the taxpayer that the minister has vacated or confirmed the assessment or has reassessed.

If the minister has confirmed the assessment or reassessed, the appeal must be filed with the TCC within 90 days after the notice of the minister's decision was sent to the registrant. Once again, the deadline starts with the sending of the notice: it is irrelevant whether the notice is ever received by the registrant (although the minister is required to send the notice by registered or certified mail, so it is usually received).

Deadline Extensions Generally

If a registrant has missed the deadline for filing an objection to a notice of assessment or a notice responding to an objection or an appeal, it may be possible to request an extension of time within one year. Extensions are not automatic, and certain requirements set out in the ETA must be satisfied before an extension will be granted. Three sections of the ETA are relevant when one is dealing with tax appeal extensions:

- 1) If you miss the deadline for filing an objection, you can apply to the minister for an extension under ETA section 303.
- 2) You can then make an application to the TCC under ETA section 304 (if the minister refuses the extension or if 90 days has elapsed without an answer).
- 3) If you miss the deadline for filing your appeal, you can apply to the TCC for an order extending the time under section 305.

Extension requests are rather frequently denied, and for this reason we generally recommend that registrants try to file an objection or an appeal within the 90-day deadline whenever possible.

Exceptional Arguments

In situations where exceptional facts are involved, tax lawyers can sometimes come up with technical arguments to try to allow for the filing of a late-filed objection or appeal.

For example, in *Titouah c. La Reine* (2017 CCI 105), the registrant filed an objection, and the minister rendered a decision upholding the assessment for unremitted GST against the registrant as the director of a bankrupt company. The minister's decision was sent to the registrant by courier, and a signed courier slip confirmed that the registrant's spouse received it three days later. The registrant did not file an appeal within 90 days of the decision being sent by courier.

The registrant applied for an extension of the time to file an appeal, which was challenged by the minister. The TCC granted the extension, noting that the registrant was actually

still within the time limit to file an appeal because the minister's decision was sent by courier, not by "registered or certified mail" as required by the ETA; accordingly, the 90-day filing deadline had never actually started to run.

The Bottom Line

If you have missed—or think you may have missed—a deadline for filing a notice of objection or a notice of appeal, get in touch with a competent tax professional as soon as possible. Time is of the essence: the sooner qualified advice is obtained, the greater the likelihood of getting an extension.

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Ontario's Vacancy Rebate and Reduction Program: Background

Editor's note: This is the first of two articles dealing with the hidden costs of eliminating Ontario's vacancy rebate and reduction program. This article describes the way in which the current program evolved, and provides a background to the second article (to appear in the April issue of Tax for the Owner-Manager), which will outline the various programs now in force and how they may be amended.

The current state of Ontario's vacancy rebate and reduction program is perhaps best summarized by Bob Dylan's lyric: "For the times they are a-changin'." Since 1998, Ontario has been the only province to provide owners of qualifying commercial and industrial buildings and land with tax rebates and reductions in the form of the vacant unit rebate and vacant/excess land subclasses. Now the Ministry of Finance has granted municipalities broad flexibility to modify the program to respond to local circumstances. The result has been that a significant number of municipalities, including the City of Toronto, have chosen to phase out or eliminate the program altogether; as Mayor John Tory told reporters in early 2017, "We are subsidizing people to keep space empty that is increasing, almost hourly, in value. . . . It is not in the best efforts of a healthy city."

Those familiar with the modern history of property tax reform in Ontario are right to question this rationale. The vacancy rebate program was originally designed to avoid additional tax liability after the business occupancy tax (BOT) was eliminated. The BOT was a tax in personam and was levied against the occupant of land, whether owner or tenant. The vacancy rebate was created to leave an owner of land in which no business was being carried on in the same tax position as it was prior to the elimination of the BOT. When the BOT was eliminated, its impact was rolled into a single property tax rate to be imposed on the owner. For many landlords and businesses, the new municipal flexibility authorized by the

ministry represents a significant change in tax policy with far-reaching and potentially destructive consequences.

The BOT was first conceived by the 1902 MacLennan commission, which recommended that local businesses be subject to a flat-rate “occupancy tax.” The goal of the MacLennan commission was to indirectly tax the income of persons engaged in trade, manufacturing, and financial or commercial businesses (other than certain exempted businesses) regardless of a person’s income level (Ontario, *Committee on Taxation Report*, vol. 2 (Toronto: Queen’s Printer, 1967) (the Smith committee)). Under the Assessment Act of 1904, a graduated BOT was based on a percentage rate of the assessed value ranging from 25 percent to 150 percent, depending on the type of business or industry. For the most part, these percentages remained unchanged until the 1980s, when the number of rates was reduced. For instance, the high rate for distillers, which was viewed by some as a way to tax the “wages of sin,” was reduced from 150 percent to 75 percent.

The 1967 report of the Smith committee characterized the current state of the property tax as regressive and inequitably administered. Among the Smith committee’s key recommendations was that all real property be assessed at “actual value” and that the province take a greater role in assessment. In 1970, the provincial government assumed the assessment function from municipalities and committed to adopting the concept of market value assessment.

Until 1998, all properties were taxed as either residential or non-residential (that is, commercial and industrial land). Property owners were assessed realty taxes based on mill rates (a set rate per \$1,000 of assessment) to reflect the property’s market value. Legislation required that the residential mill rate be equal to 85 percent of the non-residential mill rate.

Although residential properties were subject to the residential mill rate, non-residential properties were subject to two related property tax rates: (1) the non-residential mill rate (assessed against the property owner), and (2) the BOT (assessed against every tenant in occupation of non-residential multi-tenanted properties). The BOT was separately assessed against every tenant on the basis of the value of the portion the tenant occupied to reflect the tenant’s share of the fair market rent for the property. Assessors would prepare a separate business assessment in respect of each tenant’s occupancy in multi-tenanted properties.

In 1998, the province introduced a new uniform assessment system based on “current value.” According to the Ontario Superior Court of Justice in *Omers Realty Corp. v. Sears Canada Inc.* (2005 CanLII 3983 (ONSC)), the BOT was abolished as part of the general property tax reform, and realty taxes for commercial and industrial properties were increased in order to make up for the revenue loss resulting from the elimination of the business tax. To assist property owners who might incur property tax increases resulting from the

elimination of the BOT, the province introduced two property tax relief programs in 1998:

- 1) *Vacant unit rebate*: This application-based program provides a property tax rebate to property owners who have vacancies in commercial or industrial buildings for at least 90 days. The amount of the rebate is currently 30 percent of the property tax for vacant commercial space and 35 percent of the property tax for vacant industrial space.
- 2) *Vacant and excess land subclasses*: Commercial and industrial properties or portions of those properties in the vacant and excess land property tax subclasses are taxed at a fixed rate below the tax rate of the broad class. These properties are currently discounted at 30 to 35 percent of the full commercial or industrial rate.

Upper- and single-tier municipalities currently have the option of applying the same percentage of relief (30 to 35 percent) to both the commercial and industrial property classes.

As Ontario’s Assessment Review Board recognized in *Haldimand County v. U.S. Steel Canada Inc.* (2016 ONSC 5286), the underlying purpose of the vacancy program is to “lessen the tax burden on properties due to a reduction in the property’s productive capacity to bear taxes. . . . [A] property that is not being used will not be productive regardless of why it is not being used.”

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