

ADDITIONAL DEFENCES TO TAX ASSESSMENTS ARISING FROM CONVEYANCES OF ASSETS TO RELATED PERSONS - PART 3

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm about additional defences which are effective in dealing with assessments issued in respect of non-arm's length transfers of property. Alpert Law Firm is experienced in providing legal services to its clients in tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions and estate administration.

A. BANKRUPTCY DISCHARGE

Recently the Courts have shifted away from accepting the bankruptcy defence to a section 160 assessment. In the past, case law indicated that if, at the time of the section 160 assessment, the transferor has filed for bankruptcy and has been released from all tax claims payable, the transferee could not be held vicariously liable under section 160 of the Act for any taxes the transferor may have owed prior to the bankruptcy discharge.

Now, the Courts generally find that even if there has been a section 160 assessment against the transferee after the transferor has been discharged from bankruptcy, it is irrelevant as far as the transferee's own liability under section 160 of the Act is concerned.

B. CORPORATE DIVIDENDS RECEIVED BY SHAREHOLDERS

Where a corporation declares dividends to its shareholders at a time when the corporation is indebted to the Minister for tax, the payment of such dividends will constitute transfers of property thereby causing the shareholders to become vicariously liable for the payment of tax owing under section 160 of the Act.

C. DIVIDENDS IN LIEU OF SALARY

Where the tax debtor is a corporation, dividends will be taken to be a transfer for the purpose of section 160(1). This can allow the CRA to hold the shareholder receiving the dividend jointly and severally liable for the amount rendered to them. In this context,

the CRA will examine whether any consideration was offered for the issuance of the dividend, including consideration by way of services rendered. Today, when a dividend is paid in lieu of salary, the taxpayer can claim that consideration was provided for the transfer where they can prove that they did not receive a salary in the given period.

This principle has only been tested where dividends were paid on a class of shares where the employee owns all of the shares of the class on which dividends were paid. In the event that two or more individuals received funds through payment of a dividend, the court would likely find that the payment was being made as a result of share holdings, and not actual work performed. In this case, the claim that consideration was provided through performance of services would be unlikely to succeed, because the dividend would be provided based on pro-rata share ownership, and not on tasks performed.

D. TRUSTS

Subsection 160(1) of the Income Tax Act only applies to property that is actually owned by the tax debtor. In some instances, trusts can interfere with this ownership and change the degree of equity that is transferred. This can change the amount that a transferee is found to be vicariously liable for.

(i) RESULTING TRUST

A resulting trust occurs where a party provides consideration in a transaction, but does not receive any benefit. In such a situation, the party who holds the property will hold it on resulting trust for the party who did not receive the property as promised. This often occurs where comingled funds are used to purchase property that is then registered under only one party's name. The party who receives the property is taken to hold it on resulting trust for the other party, to the extent that the other party can be taken to have contributed to the consideration paid.

(ii) CONSTRUCTIVE TRUST

A constructive trust is created where one party is unjustly enriched by the actions of another, generally in the improvement of a property. In this situation, the unjustly enriched party is held to hold some of the improved property in trust for the party who improved it without consideration. This can occur where one member of a marriage owns a property, and the other improves it for no consideration. The Tax Court cannot impose this sort of

trust, as they are not a court of equity. The taxpayer can, however, appeal to a court of equitable jurisdiction to receive some of the equity in the property on constructive trust.

E. BENEFICIARIES OF TRUSTS AND ESTATES

Recent case law has indicated that beneficiaries of a trust or estate can be held vicariously liable for the tax owing of the trust or estate, pursuant to subsection 160(1) of the Act. Whether or not the beneficiaries knew or consented to the transfer of such funds to them has been found to be a non-issue by the Courts, in regards to being found vicariously liable for the tax debt of the trust or estate.

In addition, Courts have found that the beneficiaries are not only liable for the amount of tax liability of the testator on the day of the testator's death, but also for the interest accrued on the tax debt before and after the testator's death pursuant to subsection 160(1) of the Act.

F. CASCADING ASSESSMENTS

Case law has indicated that cascading assessments can also be made under subsection 160(1) of the Act to find a transferee liable for tax owing by a transferor who itself is liable for taxes under subsection 160(1) of the Act.

G. MISTAKE OF FACT

As a residual matter, the Court retains the discretion to allow a taxpayer to undertake steps to alter a transaction that was a bona fide mistake. The taxpayer is required bring adequate evidence to show that a mistake in the transaction caused the result to not reflect the intentions of the parties. In such a case, transfers intended to remedy the mistake can be made without subsection 160(1) applying. This is unlikely to succeed often, as it would require substantial evidence, but might apply in rare situations where property was in the wrong hands as a result of a genuine mistake in the contract of sale.

This issue of the Legal Business Report is designed to provide information of a general nature only and is not intended to provide professional legal advice. The information contained in this Legal Business Report should not be acted upon without the further consultation with professional advisers.

Please contact Howard Alpert directly at (416) 923-0809 if you require assistance with tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions or estate administration.

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