

# THE Canadian TAXPAYER

Pages 177-184

Editor: Arthur B.C. Drache, C.M., Q.C.

Nov. 23, 2010 - Dec. 6, 2010 — Vol xxxii No. 23

## OFFSHORE BANKING AND THE CRA: FICTION AND FACT (PART I)

David H. Sohmer

*Editor's note: This is the first of two articles on the subject. The second will appear in our next issue.*

In an era of twitter, texting and multi-tasking, truth is often compromised for the sake of brevity. When politicians focus on the 30-second sound clip and journalists focus on sound bites, compromising the truth can compromise the national interest. Given the state of the country's fiscal health, the estimated \$100 billion which Canadians hold offshore is a matter of national interest which should not be compromised by electoral politics or the pursuit of advertising revenue.

### A. Fiction

"... Why are people coming forward (through the CRA's voluntary disclosure program)? Because we are cracking down harder than ever on Canadians who are not paying their taxes."

Keith Ashfield, Minister of National Revenue in a letter to *The National Post* dated October 9th, 2010.

### Fact

The increased number of disclosures has had little to do with the CRA "cracking down harder than ever". The increase is primarily due to the following:

- 1) The Canadian Securities Administrators announced changes to the registration requirements for all investment dealer and adviser firms doing business in Canada effective as of September 28, 2009. National Instrument 31-103 provides that international dealers and international advisers can rely on an exemption provided that they only act for a "permitted client" which is defined to mean, *inter alia*, "an individual who beneficially owns financial assets ... having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds \$5 million"; UBS and Credit Suisse contacted all account holders residing in Canada and requested them

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THE  
Canadian  
TAXPAYER

Editor: Arthur B. C. Drache, C.M., Q.C.  
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ISSN 0225-0608

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Subscription rate: \$468 per year, plus shipping, handling and GST  
Published Twice Monthly

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WE ACKNOWLEDGE THE FINANCIAL SUPPORT OF THE GOVERNMENT OF CANADA, THROUGH THE PUBLICATIONS ASSISTANCE PROGRAM (PAP), TOWARD OUR MAILING COSTS.  
PAP REGISTRATION #8961  
PUBLICATIONS MAIL AGREEMENT #1410091

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## B. Fiction

"People who lie and cheat should be hunted down and punished as severely as other nations do. This is no way to run a country and smacks of corruption. Or of outright incompetence."

Diane Francis, "Canada: Sucker Nation for Tax Cheats" October 7, 2010," *The National Post*.

## Fact

- 1) Most tax authorities have voluntary disclosure programs. As part of its attack on Americans with offshore accounts, the IRS used a velvet glove as well as an iron fist. A temporary partial amnesty required persons disclosing under the program to pay tax and interest on six years of income, an accuracy penalty of 20 percent to 25 percent of the tax owing and an additional penalty of 20 percent of the highest amount in the account over the 6-year period. The program was successful not only because it was accompanied by vigorous enforcement but because it gave taxpayers and tax practitioners certainty and consistency in how their cases will be handled and found a balance between what taxpayers are willing to pay and what should be paid to be fair to compliant taxpayers. The U.K. and Italy have also introduced temporary partial amnesty programs.
  - 2) The U.S. introduced the *Foreign Account Compliance Tax Act of 2009* ("FACTA") which applies to payments made by foreign financial institutions ("FFIs") with U.S. investment income beneficially held by their clients. U.S.-source investment income and gross proceeds from the sale of U.S. securities will be subject to a 30-percent withholding tax unless the FFI agrees to disclose, on an annual basis, information about the foreign financial accounts of U.S. persons. The introduction by Canada of FACTA-type legislation would not only be ineffective, it would be counter-productive. Avoiding investments in Canadian securities would not require a material change in investment strategy. Furthermore, as Jack Mintz, Director of the University of Calgary's School of Public Policy, told the Canadian Press, "Switzerland is one of the major countries that we
- to certify that they were permitted clients. Those account holders who did not meet the \$5-million threshold were advised to consult Canadian tax advisers with a view to availing themselves of the voluntary disclosure program.
- 3) In 2006, an employee of LGT Truehand, a Liechtenstein bank, provided the German tax authorities with the names of more than 1,400 clients with secret accounts. Germany provided Canada with information that 106 Canadian residents had approximately \$100 million in accounts with the bank.
  - 4) French tax authorities were given records of HSBC secret bank accounts which had been stolen by a former employee of the bank. France provided Canada with details on about 1,800 accounts held by Canadians.

borrow from, they play a significant role here in financing Canadian investments”.<sup>1</sup>

- 3) FACTA buttressed the U.S. qualified intermediary program, and it was the UBS circumvention of its obligations under this program which constituted the legal foundation for the U.S. attack on UBS. The U.S. also had significant economic leverage over UBS because of the magnitude of UBS operations in the U.S. In 2008, UBS had 27,362 fulltime personnel in the United States, 26,406 fulltime personnel in Switzerland, and only 1,984 fulltime personnel in the rest of the Americas. UBS shares were also listed on the New York Stock Exchange. As at July 31st, 2009, UBS Bank (Canada) had total assets of \$830 million and the UBS AG Canada branch had total assets of \$733 million. It is evident from the foregoing that Canada lacks the economic muscle to unilaterally compel foreign financial institutions to provide it with the information necessary to support effective enforcement activities.
- 4) Reliable and relevant information is required to combat tax evasion, and the modest size of the Canadian economy limits its ability to obtain such information by acting unilaterally. In recognition of this fact, Canada has entered into bilateral tax treaties which provide for the exchange of information. A protocol amending the Canada-Switzerland Tax Convention was signed on October 22nd, 2010 which, *inter alia*, adopted the OECD standard on exchange of information. Canada has also entered into tax information exchange agreements with countries that are not parties to tax treaties with it. Canada was an active participant in the OECD efforts to develop an internationally agreed tax standard. Canada was a participant at the April 2nd, 2009 London Summit at which the G20 leaders called on countries to adopt the international tax standard. As at October 4th, 2010, all jurisdictions surveyed by the Global Forum on Transparency and Exchange of Information for Tax Purposes had committed to the internationally agreed tax standard. Canada was a member of the

focus group set up by the OECD to carry out a follow-up study on high-net worth individuals. Canada has signed, but not yet ratified, the Joint Council Of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters which provides, *inter alia*, for the exchange of information and assistance in recovery of taxes.

- 5) Ms. Francis’s allegations of incompetence are based on the fact that out of 106 cases of Canadians with accounts at LGT Truehand, 68 had been completed as of June 26, 2010, including 20 who came forward under the Voluntary Disclosure Program (“VDP”). The CRA VDP Guidelines provide that a disclosure is considered voluntary if it has been initiated “before enforcement action has been initiated that could lead the CRA to the issue being disclosed”. It is assumed that the 20 disclosures were commenced before enforcement action had been initiated. Delays in processing similar files are not unique to Canada. One year after the IRS temporary amnesty program closed, it was estimated that only 5 to 10 percent of all cases were “remotely near the signing of a closing agreement”.<sup>2</sup>

### C. Fiction

“The era of banking secrecy is over.”

Global Plan for Recovery and Reform: The Communiqué from the London Summit. London, 2 April 2009. [url:http://www.londonsummit.gov.uk/en/summit-aims/summit-communicue](http://www.londonsummit.gov.uk/en/summit-aims/summit-communicue).

### Fact

- 1) The internationally agreed tax standard with respect to the exchange of information is Article 26 of the OECD Model Tax Convention on income and capital. Article 26 does not permit countries to engage in “fishing expeditions” or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer.

<sup>1</sup> <http://www.cbc.ca/money/story/2010/10/20/canada-offshore-account-swiss-banks.html>.

<sup>2</sup> Mark E. Matthews and Scott D. Michel, “IRS’s Voluntary Disclosure Program for Offshore Accounts: A Critical Assessment After One Year.” Source: Daily Tax Report: News Archive > 2010 > September > 09/21/2010 > BNA Insights > Tax Evasion: IRS’s Voluntary Disclosure Program for Offshore Accounts: A Critical Assessment after one year.

The protocol amending the Canada-Switzerland Tax Convention signed on October 22nd, 2010 is consistent with Article 26 of the OECD Model Convention and requires a requesting state to provide the name of the taxpayer and the name of any person believed to be in possession of the requested information. It specifically prohibits “fishing expeditions” and provides that there is no obligation to exchange information on an automatic or spontaneous basis.

- 2) Anecdotal evidence indicates that many offshore accounts have not had deposits or withdrawals for over a decade so Canada is unlikely to know the identity of the taxpayers or the banks. The protocol does not subject these taxpayers to a clear and present danger of detection.
- 3) The revenue rule is a well-recognized rule that the authorities of one state will not assist in the recovery of taxes due to another state. Article XXVI of the Canada-U.S. Tax Treaty provides an exception to the revenue rule but it is doubtful whether amounts that may be due under [section 160](#) of the ITA constitute a tax covered by the provision.<sup>3</sup>
- 4) The Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters provides for assistance in recovery of taxes. However, many countries have not signed while other countries, including Canada, have signed but have not yet ratified the Convention. Papers delivered at the 2010 International Fiscal Association Annual Conference in Rome indicated that while mutual assistance in collection is increasingly the norm in international tax law, it still does not provide effective remedies. The focus group established for the OECD project on high net-worth individuals recognized that high net-worth individuals are not homogeneous, show high mobility, and have far less interaction with tax administrations than large corporate taxpayers.

James Carville, the American political consultant, was asked why the Democrats have not been able to sell the message that their stimulus package will eventually translate into jobs or that it prevented a larger economic disaster. Mr. Carville answered that “the message was not sharp enough nor was it populist enough”.

The settlement initiative developed by the IRS to encourage disclosures of offshore accounts has been described as “what may have been the most extraordinarily successful tax compliance feat in American history”.<sup>4</sup> Canadian electoral politics may compromise the ability of the CRA to follow the lead of the IRS because fiction is sharper and more populist than fact when the issue is offshore banking.

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<sup>4</sup> Matthews and Michel, *supra*, note 2.

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## CAMPBELL RESIGNATION ADDS TO HST SOAP OPERA IN B.C.

In the face of sustained public anger over the harmonized sales tax, B.C. Premier Gordon Campbell resigned on November 4, saying he was getting in the way of his own government. Campbell told reporters at a hastily arranged news conference in Vancouver that any progress made by his government was being overshadowed by questions about his leadership.

“When public debate becomes focused on one person, as opposed to what’s in the best interests of the province of British Columbia, we’ve lost sight of what is important,” Campbell said. “When that happens, it’s time for a change.”

The decision was made in the wake of the obvious, Campbell having lost the confidence of his caucus, the cabinet and of course the public at large.<sup>1</sup>

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<sup>3</sup> See *Bleau v. R.* (2006), [2008] 1 C.T.C. 2178, 2008 D.T.C. 3100 (T.C.C. [General Procedure]), affirmed 2007 CarswellNat 5629, 2008 D.T.C. 6516 (F.C.A.).

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<sup>1</sup> But perhaps not the party rank and file. He received an 84-percent endorsement from B.C. Liberal Party members, the party said in a news release. The party convention at which those results would have been revealed has been cancelled in the wake of Mr. Campbell’s snap resignation.



As readers are well aware, the fight over the HST resulted in a referendum call for September 24, 2011. But that did not assuage voter anger.<sup>2</sup>

In the run-up to the resignation, Campbell struggled to turn the tide. First he announced a massive cabinet shuffle involving 16 ministers and the replacement of members of his own staff and some deputy ministers.

Two days later on a provincially televised program, he announced major tax cuts for January 1, 2011. (See details below.)

But neither move seemed to have any effect on the irate voters.

His resignation (no effective date has been set for his actual departure) will require a leadership convention. Given the fixed-date electoral system in the province, his successor will govern for almost two years before facing the electorate. But there are huge questions facing the new premier.

- Will the tax cuts remain? (Almost certainly the answer is yes.)
- Will the cabinet shuffle stick, especially with regard to Colin Hansen who remains as Finance Minister? (Almost certainly no.)
- Will the HST be cancelled or substantially modified before the referendum date? (Probably not given the enormous costs of doing so including, presumably, repaying the federal government the billions sent to facilitate the change-over.)
- Can an “education campaign” turn around voter reaction to the HST? ( Probably not.)

The ultimate question is whether having metaphorically received Campbell’s head on a platter, will the electorate be placated? Who knows?

But what is abundantly clear is that in the months ahead there will be huge uncertainty in the business community which largely supported the

HST (the only sector that did) and that cannot be good for the province’s economy.

The fact that Campbell, who has been one of the most electorally successful politicians in the province in the post-war era, could fall so swiftly and decisively should send a message to all elected representatives to the effect that even a majority does not allow a government to push ahead with major initiatives without public consultation and input.

**The Tax Cuts:**

Assuming (as we do) that the tax cut proposal is implemented, the tax rates for the first two personal income tax brackets will be reduced by 15 percent.

Personal Income Tax Rates—2011 Tax Year		
Tax bracket	Current rate	New rate
\$0 to \$36,146	5.06 %	<b>4.30 %</b>
\$36,146 to \$72,293	7.70 %	<b>6.525 %</b>
\$72,293 to \$83,001	10.50 %	10.50 %
\$83,001 to \$100,787	12.29 %	12.29 %
Over \$100,788	14.70 %	14.70 %

The cost of this tax reduction to taxpayers totals \$568 million in 2011-12 rising to \$638 million in 2013-14. The B.C. government claims to continue to be on track to balance the budget in 2013-14 as committed in previous budgets.

Planned 2011 Tax Cut				
Income	Before reduction	After reduction	Tax cut	% reduction
\$20,000	\$138	\$70	<b>-\$68</b>	<b>-49 %</b>
\$30,000	\$957	\$813	<b>-\$144</b>	<b>-15 %</b>
\$40,000	\$1,565	\$1,329	<b>-\$236</b>	<b>-15 %</b>
\$50,000	\$2,335	\$1,981	<b>-\$354</b>	<b>-15 %</b>
\$60,000	\$3,105	\$2,633	<b>-\$472</b>	<b>-15 %</b>
\$70,000	\$3,875	\$3,285	<b>-\$590</b>	<b>-15 %</b>
\$72,000	\$4,029	\$3,415	<b>-\$614</b>	<b>-15 %</b>
\$80,000	\$4,860	\$4,244	<b>-\$616</b>	<b>-13 %</b>
\$90,000	\$6,035	\$5,419	<b>-\$616</b>	<b>-10 %</b>
\$100,000	\$7,264	\$6,648	<b>-\$616</b>	<b>-8 %</b>

<sup>2</sup> See issue # 20 of this volume of *The Canadian Taxpayer* at page 153.

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## SECOND CAREER FEDERAL BY-ELECTIONS

The government has set Monday, November 29, for federal by-elections in the electoral districts of Dauphin—Swan River—Marquette (Manitoba), Winnipeg North (Manitoba), and Vaughan (Ontario).

In each case the vacancy came about because sitting members of the Commons decided to take a run at the mayor's job in their home cities. In each case the sitting member has eligibility for a handsome federal pension and the mayor's job would not have the effect of deferring those pensions as would have been the case had the individual taken a federal sinecure.

Robert Sopuck will be running for the Conservatives in Dauphin—Swan River—Marquette, while a Liberal candidate has yet to be determined. The riding was previously held for years by Tory Inky Mark, who decided to campaign in Dauphin's municipal election. Mark was clearly at the end of his federal career with no hope of further promotion. This was thought to be a slam dunk for the Tories.

The Winnipeg North riding fell vacant last April when former NDP MP Judy Wasylycia-Leis chose to run for mayor. NDP candidate Kevin Chief is running for the seat against Liberal MLA Kevin Lamoreux and Tory Julie Javier. The Liberals have a realistic shot at this seat given the progressive views of the public which go back generations but the NDP remains strong.

Vaughan was held by Liberal Maurizio Bevilacqua for the past 22 years. The Tories have nominated high-profile candidate Julian Fantino, former Ontario Provincial Police commissioner. Mr. Fantino will be running against NDP candidate Kevin Bordian and Liberal Tony Genco.

This is the most interesting seat given that Vaughan has been solidly Liberal but whether that has been because of Bevilacqua's personal popularity or otherwise remains to be seen.

The day the by-elections were called, the Tory spin was that the Liberals were likely to win two seats...setting the bar unrealistically high for Michael Ignatieff.

There is one other vacancy. Jean-Yves Roy, a Bloc member from Haute-Gaspésie—La Mitis—Matane—Matapédia (Quebec) resigned in early October and no plans have been announced for a by-election.

### And the results

So what happened to the post-Parliamentary retirement plans of the three MPs?

The day after the by-elections were called Bevilacqua won a landslide victory facing off with incumbent Linda Jackson. With all polls counted, Bevilacqua had 45,049 votes, to about 10,000 each for Jackson and former Liberal MPP Mario Racco.

But things didn't turn out as the former MPs hoped in Manitoba where municipal elections were held two days after those in Ontario. Wasylycia-Leis lost her run against incumbent mayor Sam Katz, and in Dauphin Inky Mark lost the mayor's race to lawyer Eric Irwin.

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## LIBERALS VENTURE INTO FISCAL POLICY GINGERLY

We have always been bemused by the polls in which Canadians believe that the Conservatives are the best party to deal with economic issues. It is arguable that their record in dealing with the economy since taking office is terrible...poor choices every which way and, as a result, a \$56-billion deficit this year which is appalling.

But perhaps the polls aren't so wrong-headed if you assume that they are not a verdict on Tory ineptitude so much as a reflection of deep-seated doubt about how the Liberals would deal with the economy.

The liberal response to the Tory economic statement of the prior week doesn't go far for making their case.

Deputy Leader (and former Finance Minister) Ralph Goodale, Finance critic Scott Brison and Industry critic Marc Garneau delivered similar speeches in mid-October in which the Liberals committed to reducing the deficit-to-GDP ratio to 1 percent within two years of taking office. In 2009-2010 the deficit-to-GDP ratio was 3.6 percent. One unstated point is that the Liberals do have experienced financial people who represent a credible team in waiting.

That having been said, there was precious little to differentiate the Grits from the Tories though in fairness the lack of available financial resources ties the arms of both parties and promises of substantial new spending or tax cuts would be greeted with scepticism, to say the least.

The Liberals repeated their pledge to cancel planned corporate tax cuts and invest the money in targeted social programs as we reported in our last newsletter.

As things stand right now (and we believe there will be more to come from both parties as we move closer to an election) the question is how much the government would “save” by cancelling the tax cuts and how the savings will be allocated if a new government took office?

One positive thing is that both parties believe that Canadians want steps taken to eliminate the deficit, something which probably wasn't true 20 years ago. But after the pain the Liberals inflicted through a string of Paul Martin budgets to get Canada's economic house in order (setting the stage for the comparatively good recent economic performance compared to the pitiful policies of the other G-8 countries) there is a desire on all sides to return to balanced budgets or even a surplus situation.

As Canadians are well aware from watching Flaherty's five-year performance, talk is cheap and forecasts as to where the economy will be in a year, much less four or five years are essentially worthless. If one is “spinning” from the Liberal side, their team is better than that of the government and their projections (even without any data) are realistic. If one takes the Tory side of the “spin factory”,

nothing the Liberals offer is very exciting except that they are “tax and spend”.

The day after the Liberal speeches the Bank of Canada (in holding its rate at 1 percent) demonstrated just how difficult forecasting is.

The Bank forecast in July 3.5-percent and 2.9-percent growth in Canada in 2010 and 2011 respectively. But in October the Bank pared this down to 3.0 percent and 2.3 percent. The 2011 forecast is a marked downgrade. The growth forecast for 2012 was upgraded from 2.2 percent to 2.6 percent. As a result of the downgraded view for 2010/11, the Bank “judges that the output gap is slightly larger and that the economy will return to full capacity by the end of 2012 rather than the beginning of that year, as had been anticipated in July”. But then the Bank's forecasts over the past few years haven't been paragons of accuracy either...so who knows how things will stand when the election finally comes.

The economic offerings of October 2010 are hardly the stuff of election campaigns but, for the Liberals, the platform (such as it is) is one more small step to answering the criticism that they have no policies on which to run the next time around.

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## PRENTICE DEPARTURE A BLOW TO MODERATION

In another piece in this issue we wrote about attempts by several former MPs to change careers with varying degrees of success.<sup>1</sup>

But it came as a huge surprise to all concerned (keeping a secret in Ottawa is well nigh impossible) when Minister of the Environment Jim Prentice rose in the Commons to announce his resignation from the cabinet at once and from the Commons on December 31.

He is leaving for a senior position with the Canadian Imperial Bank of Commerce and a salary likely in excess of a million dollars. John Baird was immediately appointed (again) as Environment Minister but this is probably temporary, pending a

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<sup>1</sup> See “Second Career By-Elections”.

cabinet shuffle after the next by-elections at the end of November. The Prime Minister also announced that Rona Ambrose will assume statutory responsibility for Western Economic Diversification while keeping her duties as Minister of Public Works and Government Services and Minister for Status of Women. Lynne Yelich will remain Minister of State for Western Economic Diversification.

Prentice has always been viewed as a moderate, a “Red Tory”, and was as close to being popular with the opposition as any government member. In short, he was also seen as a moderate and a decent and civil person, something which a lot of people view as being a rarity amongst the latter-day Conservatives in the Commons.

The pundits are debating whether the move marks an end to his political ambitions (he of course says yes) or whether he is biding his time outside Ottawa à la John Turner.

He is only 54 and had said (as so many do) that he envisioned a 10-year political career. He will have served nine years. He was immensely capable as a minister and we gather something of a work horse. He’ll be hard to replace as to quality but there will be many in the Tory caucus who privately cheer his departure, not only because of his moderate views but because it opens up promotion opportunities.

He will be missed by those segments of the public which still hope that the government will shift more to the centre, aligning itself with the bulk of the Canadian electorate.

## NEW TAX COURT JUDGE NAMED

The practice of using the federal courts as a home for retiring civil servants continues apace. But the most recent appointee to the Tax Court has the hallmark of actually being a person who knows something about tax.

Johanne D’Auray, who was Assistant Deputy Minister and Counsel with the Department of Finance Canada, was appointed a Judge of the Tax Court of Canada to replace Mr. Justice A. Tardif, who elected to become a supernumerary judge as of September 27, 2010.

She received a Bachelor of Commerce in 1979 and a Bachelor of Civil Laws (LL.L.) in 1982 from the University of Ottawa. She was admitted to the Quebec Bar in 1983.

She has been Assistant Deputy Minister and Counsel with the Department of Finance Canada since August 16th, 2010. Prior to that, she was with the Department of Justice as Assistant Deputy Attorney General and Head of the Tax Law Services Portfolio from 2005 to 2010, Regional Director General of the Quebec Regional Office from 2003 to 2005, Associate Assistant Deputy Attorney General from 2002 to 2003, Senior General Counsel — Civil Litigation Section from 1998 to 1999 and Counsel on financial law from 1984 to 1998. She was with the Competition Bureau at Industry Canada from 1999 to 2002. Her main areas of practice were tax litigation, Aboriginal and insolvency law.

D’Auray was a member of the Liaison Committee as well as of the Rules Committee for the Tax Court of Canada. She was Governor for the Canadian Tax Foundation and a frequent speaker and lecturer on tax issues, most notably at the Canadian Tax Foundation National Conferences.

## CPP NUMBERS FOR 2011

The CRA has announced that the maximum pensionable earnings under the Canada Pension Plan for 2011 will be \$48,300 — up from \$47,200 in 2010. The new ceiling was calculated according to a legislated formula that takes into account the growth in average weekly wages and salaries in Canada.

The basic exemption amount for 2011 remains \$3,500. Individuals who earn less than that amount do not have to contribute to the CPP.

The employee and employer contribution rates for 2011 will remain unchanged at 4.95 percent, and the self-employed contribution rate will remain unchanged at 9.9 percent.

The maximum employer and employee contribution to the plan for 2011 will be \$2,217.60, and the maximum self-employed contribution will be \$4,435.20. The maximums in 2010 were \$2,163.15 and \$4,326.30.