

Tax

How to open Pandora's tax box

By **Jonathan Éthier**

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(January 13, 2021, 11:01 AM EST) -- When a person owes money to the tax authorities, it could be perilous for that person to try to remove important assets from his or her personal patrimony (e.g., a house, a luxury car) by transferring them to a relative (e.g., his or her spouse, a child). This type of transaction to shelter assets from the tax authorities is not without risk for the person receiving the assets.

Section 160 of the *Income Tax Act* (ITA) provides that when a tax debtor transfers property (e.g., cash, assets) in the course of a non-arm's length transaction, the person receiving the property may be jointly and severally liable for the transferor's debt with the transferor, or even for the interest payable. A similar regime exists in Quebec tax law.

At the federal level, it will be open to the minister to assess the transferee at any time, no limitation period being applicable in such circumstances. Ultimately, the person who received the property may be assessed for the lesser of the value of the property received and the tax debtor's debt.

That said, the transferor's tax debt must have been crystallized at the time of the transfer. Otherwise, the minister could not validly issue a notice of assessment to the person who received the property since he or she would have obtained it from a person whose tax liability does not yet exist.

Colitto case

In April 2020, the Federal Court of Appeal in *Colitto v. Canada* [2020] F.C.J. No. 510 clarified when the tax liability of a director of a corporation can arise in the context of assessments issued to his spouse (the taxpayer) under s. 160 of the ITA.

In this case, the taxpayer had received in 2008 half of two properties with a total value of approximately \$230,000 for the modest sum of \$4. The properties had been transferred to her from her spouse who was a director of a corporation. The corporation in question had failed to remit its source deductions (SD) to the minister for the period from February to August 2008. Almost two years after receiving half of the properties, the taxpayer's spouse had been personally assessed for the corporation's unpaid SD under s. 227.1(1) of the ITA.

The legal procedure prior to assessing a director generally requires that a certificate be registered in the Federal Court specifying the amount for which the corporation is liable (which had occurred in August 2009 in this case). A director is also not liable unless execution for that amount has been returned unsatisfied in whole or in part (which had occurred in January 2011 in this case).

At trial, the Tax Court of Canada was of the opinion that the liability of the taxpayer's spouse (for the corporation's SD) could not have arisen until the above-mentioned conditions had been satisfied, namely, the registration of a certificate with the Federal Court and the fact that the corporation's debt had been executed and returned unsatisfied.

Thus, the court decided that the director's liability with respect to the corporate tax debt had been crystallized in January 2011 and not in 2008, the year of the real estate transfer and the corporation's failure to pay its SD. The taxpayer was successful at first instance and the assessments were cancelled.

However, the Federal Court of Appeal overturned this decision, holding instead that the unpaid SD were amounts that the director was liable to pay in or in respect of the 2008 taxation year. In other words, the tax liability of the taxpayer's spouse was crystallized in 2008 (and not later), 2008 being the taxation year in which the real estate transfers took place.

In short, the fact that tax legislation makes the "triggering" of a director's liability subject to the fulfilment of certain administrative preconditions does not alter the moment when the personal liability in question arises or crystallizes.

In any case, for taxpayers feeling the heat with the tax authorities, it may be appropriate to consult a professional before transferring their assets to a relative, whether by donation or a low-price sale. These could be true poisoned chalices.

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