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TAX COLLECTION: THE RISK OF LESS THAN FAIR MARKET VALUE PROPERTY TRANSFERS

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ABSTRACT

This article reviews recent and pertinent case law in respect of one of the more powerful collection tools granted to the Canada Revenue Agency (CRA) under subsection 160(1) of the federal Income Tax Act and subsection 325(1) of the federal Excise Tax Act. These provisions extend the collection powers of the CRA beyond the tax debtor, allowing it to potentially pursue any non-arm's-length transferee who has received property from the tax debtor, by making the transferee jointly and severally liable for the tax debtor's debt. The willingness of the CRA to utilize this power, and the very real risk that taxpayers may unwittingly become caught in its grasp, merit a review of these provisions and the recent and relevant case law. The article provides guidance on the breadth and possible limits of the provisions, with a focus on their implications for individuals and for owner-managers of private corporations.

KEYWORDS: ASSESSMENTS ■ TAX COLLECTIONS ■ PAYMENTS ■ TRANSFERS ■ TAX LIABILITY

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INTRODUCTION

The Canada Revenue Agency (CRA) has been granted very broad powers under the Income Tax Act.[1] For example, it has been granted the authority (with only limited exceptions) to

- inspect, audit, or examine not only the records of a taxpayer, but also the records of other persons that may contain information in respect of the taxpayer and/or the taxpayer's liability for tax;[2]
- enter into premises (other than a dwelling-house) and require the owner of the premises, as well as any other person at the premises, to give reasonable assistance and answer proper questions;[3] and

1 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the ITA").

2 ITA paragraph 231.1(1)(a).

3 ITA paragraphs 231.1(1)(c) and (d).

- require any person to provide any information or document for any purposes related to the administration or enforcement of the ITA.[4]

Arguably, Parliament has granted the CRA these powers in order to "protect the fisc," in an effort to ensure that the correct amount of tax is paid by all taxpayers, given Canada's self-assessment tax system.

In a similar vein, the CRA has been granted significant collection powers. As the Federal Court of Appeal noted in *Canada v. Livingston*, "[t]he power to tax means little without the power to collect."[5] Examples of the CRA's collection powers include the following, found in ITA sections 222 through 229:

- extending the limitation period that would normally apply in respect of the collection of a tax debt;[6]
- certifying an amount payable under the ITA, and registering that amount in the Federal Court, thereby creating a judgment with the same effect as any other judgment of that court;[7]
- registering, and enforcing, the above-noted "created" judgment against property of the tax debtor;[8]
- issuing garnishments, without needing to obtain prior court authority;[9] and
- recovering amounts owing by a tax debtor by setting them off against other amounts owing to the tax debtor by the government.[10]

This article reviews relevant and recent case law dealing with one of the CRA's most powerful collection tools, found in ITA subsection 160(1) and subsection 325(1) of the Excise Tax Act.[11] These provisions grant the CRA the ability to potentially collect a person's tax debt from other, non-arm's-length parties.

ITA SUBSECTION 160(1) AND ETA SUBSECTION 325(1)

Generally, where property is transferred by a tax debtor to certain persons for less than fair market value, joint and several liability will arise, and the recipient of the property may be liable for all, or a portion, of the tax debt.

4 ITA subsection 231.2(1).

5 2008 FCA 89, at paragraph 1.

6 ITA section 222.

7 ITA section 223.

8 Ibid.

9 ITA section 224.

10 ITA section 224.1.

11 RSC 1985, c. E-15, as amended (herein referred to as "the ETA").

Under ITA subsection 160(1) and ETA subsection 325(1), where a tax debtor has transferred property[12] to

- the tax debtor's spouse or common-law partner, or a person who has since become the tax debtor's spouse or common-law partner,
- a person who was under 18 years of age at the time of the transfer,[13] or
- a person with whom the tax debtor was not dealing at arm's length,

the recipient of the property is made jointly and severally liable to pay the lesser of

- the tax owing by the tax debtor and
- the difference between the fair market value of the transferred property less the consideration, if any, paid for the property by the recipient.

The effect of these provisions can be illustrated by the following simple example.

Example 1

Spouse A has a tax debt of $10,000.[14]

Spouse A transfers $7,000, in cash, to spouse B for no consideration.

As a result, the CRA assesses spouse B (the recipient/transferee) for $7,000,[15] this amount being the lesser of spouse A's tax debt ($10,000) and the difference between the value of the property transferred less the consideration paid ($7,000 − 0 = $7,000).

The Employment Insurance Act[16] and the Canada Pension Plan[17] both incorporate ITA section 160, with such modifications as are necessary. Similar provisions are included in the income tax statutes of Canada's provinces and territories.[18]

12 Noting that "property" is broadly defined by ITA subsection 248(1), while the definition of "property" in ETA subsection 123(1) is broadened to include "money" for the purposes of ETA subsection 325(1) via ETA subsection 325(5).

13 It is interesting that this condition is not limited to non-arm's-length parties.

14 For the purposes of this example, it is assumed that no interest is being charged by the CRA.

15 For reasons that I have never been able to determine in my communications with the CRA, ITA subsection 160(1) and ETA subsection 325(1) assessments always seem to presume that at least $1 of consideration has been paid. So, in example 1, the assessment of spouse B would likely be $6,999.

16 SC 1996, c. 23, as amended, section 99.

17 RSC 1985, c. C-8, as amended, section 23(2).

18 See, for example, British Columbia, Income Tax Act, RSBC 1996, c. 215, as amended, section 34; Alberta Personal Income Tax Act, RSA 2000, c. A-30, as amended, section 52(1); Saskatchewan, Income Tax Act, RSS 1978, c. I-2, as amended, section 19; Income Tax Act, 2000, SS 2000, c. I-2.01, as amended, section 86; Manitoba Income Tax Act, CCSM c. I10, section 22; Ontario, Income Tax Act, RSO 1990, c. I.2, as amended, section 14; New Brunswick Income Tax Act, SNB 2000, c. N-6.001, as amended, section 78; Nova Scotia, Income Tax Act, RSNS 1989, c. 217, as amended, section 56; Prince Edward Island, Income Tax Act, RSPEI 1988, c. I-1, as

THE PURPOSE OF THE PROVISIONS

The purpose of ITA subsection 160(1) and ETA subsection 325(1) is to prevent a tax debtor from transferring assets in order to avoid paying tax. As the Federal Court of Appeal stated in *Medland v. The Queen*,

> the tax policy embodied in, or the object and spirit of subsection 160(1), is to prevent a taxpayer from transferring his property to his spouse in order to thwart the Minister's efforts to collect the money which is owed to him.[19]

While the goal may be uncontestable, ITA subsection 160(1) and ETA subsection 325(1) provide the CRA with extraordinary collection powers as compared with the rights and remedies available to other creditors. In fact, Sharlow JA, writing for the Federal Court of Appeal in *Wannan v. Canada*, referred to these provisions as "draconian."[20]

In a normal debtor-creditor relationship, a creditor who faced a situation where a debtor had transferred property to a non-arm's-length party for less than fair market value consideration (thereby depriving the creditor of access to an asset against which to collect) would be forced to commence a court action. This would likely be done pursuant to fraudulent conveyance legislation,[21] with the goal of obtaining a court order that would effectively reverse the transfer, thereby once again making the property accessible to the creditor.

Parliament decided that it would not put the CRA to such effort. Instead, the CRA is able to pursue, via a tax assessment, the recipient (transferee) for the difference in the value of the property received and the value of the consideration "paid" (if any), up to the amount of tax owed by the tax debtor/transferor.

Furthermore, since the recipient is now subject to a tax assessment, the CRA can exercise all of the powers it has to collect on any tax assessment (as outlined earlier in this article), even though the recipient has not actually incurred a "tax debt."

THE FOUR CONDITIONS FOR THE APPLICATION OF THE PROVISIONS

In *Livingston*, the Federal Court of Appeal outlined the four conditions for ITA subsection 160(1) (and ETA subsection 325(1)) to apply:

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amended, section 48; Newfoundland and Labrador, Income Tax Act, 2000, SNL 2000, c. I-1.1, as amended, section 54; Yukon, Income Tax Act, RSY 2002, c. 118, as amended, section 28; Northwest Territories, Income Tax Act, RSNWT 1988, c. I-1, as amended, section 19; and Nunavut, Income Tax Act, RSNWT (Nu) 1988, c. I-1, as amended, section 19. Quebec has enacted legislation that includes provisions that are similar but not identical to ITA section 160: Tax Administration Act, RSQ c. A-6.002, sections 14.4 through 14.7.

19 98 DTC 6358, at paragraph 14 (FCA). See also *The Queen v. Hewett*, 98 DTC 6003 (FCA).

20 2003 FCA 423, at paragraph 3.

21 See, for example, Manitoba's Fraudulent Conveyances Act, CCSM c. F160.

1) The transferor must be liable to pay tax under the Act at the time of transfer;
2) There must be a transfer of property, either directly or indirectly, by means of a trust or by any other means whatever;
3) The transferee must either be:
   i. The transferor's spouse or common-law partner at the time of transfer or a person who has since become the person's spouse or common-law partner;
   ii. A person who was under 18 years of age at the time of transfer; or
   iii. A person with whom the transferor was not dealing at arm's length.
4) The fair market value of the property transferred must exceed the fair market value of the consideration given by the transferee.[22]

These conditions are discussed in more detail below.

Condition 1: The Transferor Must Be Liable To Pay Tax

The Amount of the Transferor's Tax Debt

Because the recipient/transferee's liability is a function of the tax liability of the tax debtor/transferor, and because the CRA is still able to attempt collection action against the tax debtor/transferor, even if the CRA pursues the recipient/transferee under ITA subsection 160(1) and/or ETA subsection 325(1), it is necessary for the taxpayers' advisers to be continuously diligent about confirming with the CRA the amount of the *current* tax liability of the tax debtor/transferor. The reason is that a reduction of the tax debtor/transferor's tax liability may correspondingly reduce the liability of the recipient/transferee (presuming that the original tax debtor's debt is reduced below the amount that was originally sought against the recipient/transferee).[23]

The significance of condition 1 can be illustrated by elaboration of the fact situation presented in example 1.

Example 2

Scenario 1: The CRA continues to pursue spouse A and ultimately collects $2,000 from him.

- Spouse B's assessment will remain at $7,000, because the remaining tax debt of spouse A ($10,000 − $2,000 = $8,000) remains greater than $7,000.

Scenario 2: The CRA continues to pursue spouse A and ultimately collects $4,000 from him.

- Spouse B's assessment will be reduced to $6,000, because the remaining tax debt of spouse A ($10,000 − $4,000 = $6,000) is now less than $7,000.

22 *Livingston*, supra note 5, at paragraph 17. Leave to appeal to the Supreme Court of Canada was dismissed on September 25, 2008.

23 See, specifically, ITA paragraph 160(3)(b) and ETA paragraph 325(3)(b).

- While the CRA should automatically revise spouse B's assessment to recognize the reduction, it is important for the adviser to continuously monitor the situation.[24]

As well, *any* payment by spouse B will reduce spouse A's tax debt, dollar for dollar.[25]

Scenario 3: The CRA is unable to collect anything from spouse A and ultimately collects on the $7,000 assessment of spouse B.

- Spouse A's liability is now reduced by the amount collected from spouse B, leaving a balance of $3,000 ($10,000 – $7,000). Spouse B's liability in respect of the tax debt is now extinguished.

The third scenario is an important consideration to keep in mind after an ITA subsection 160(1)/ETA subsection 325(1) assessment has been issued. It is important to ensure, where possible, that any payments or collection efforts result in a reduction of the recipient/transferee's tax liability, since both the tax debtor/transferor and the recipient/transferee receive a 1:1 credit for any such payment. However, given that the tax debtor's debt often exceeds the amount of the recipient's ITA subsection 160(1)/ETA subsection 325(1) assessment, payments against the tax debtor's debt do not necessarily benefit both parties.

Tax Debt Arising After the Transfer

In the Federal Court of Appeal decision in *Addison & Leyen Ltd. v. Canada*,[26] Sharlow JA noted that as a result of the wording of ITA subsection 160(1),[27] any tax debt arising in the year of the transfer will be subject to the provision. For example, in the case of a transfer between individuals, a January transfer may raise an assessment under ITA subsection 160(1), even if the tax debt of the transferor does not arise until December of the same year.

The Validity of the Assessment Establishing the Tax Debt

The Federal Court of Appeal has held that a recipient who is made subject to an assessment under ITA subsection 160(1) or ETA subsection 325(1) may be able to challenge the underlying assessment of the tax debtor, *even if the tax debtor's liability has already been judicially determined*.

In *Gaucher v. The Queen*,[28] the taxpayer's former husband was assessed for approximately $350,000 of tax, with the assessment ultimately being confirmed by the

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24 In *Cappadoro v. The Queen*, 2012 TCC 267, it was confirmed that at appeal, the minister of national revenue has the onus to prove the transferor's tax debt that forms the basis of the ITA subsection 160(1)/ETA subsection 325(1) assessment.

25 See, specifically, ITA paragraph 160(3)(a) and ETA paragraph 325(3)(a).

26 2006 FCA 107, at paragraph 65.

27 And, as noted by David M. Sherman in *Canada GST Service* (Toronto: Carswell) (looseleaf, DVD, and online), in respect of ETA subsection 325(1) as well (within the same reporting period).

28 2000 DTC 6678 (FCA).

Tax Court of Canada.[29] Shortly before the Tax Court confirmed the former husband's assessment, he transferred a residence to the taxpayer. The value of the home, less the consideration paid by the taxpayer to her former husband, was greater than the tax debt of the former husband. A few months later, the former husband declared bankruptcy and the taxpayer was assessed pursuant to ITA subsection 160(1).

In the taxpayer's appeal to the Tax Court, she raised the argument that the CRA had reassessed her former husband after the normal reassessment period had expired.[30] The Tax Court found that the taxpayer was precluded from raising this defence, since her former husband's assessment had been confirmed by the Tax Court.

The Federal Court of Appeal disagreed, finding that because the taxpayer was not an actual party to her former husband's Tax Court appeal, she could not be bound by any judgment flowing from that appeal. Accordingly, the taxpayer had a full right to challenge her assessment, which included attacking the primary assessment (that of her former husband) that formed the basis of her assessment.[31]

Caution, however, is advised in relying on this case. The former husband had not raised the expiry of the normal reassessment period in his appeal before the Tax Court. If he had, it is questionable whether findings flowing from that decision could be overturned by a subsequent court. As Rothstein JA noted in the Court of Appeal's decision, "[t]he secondary taxpayer is entitled to raise any defence that the primary taxpayer could have raised against the primary assessment."[32]

Therefore, a recipient of an ITA subsection 160(1)/ETA subsection 325(1) assessment, while entitled to challenge the underlying assessment, may be limited to defences that were not raised (or, possibly, not fully raised) by the tax debtor. If the tax debtor does not dispute the assessment creating the tax debt (as, in my experience, is quite common), a full slate of defences will normally be available to the recipient.

Bankruptcy of the Tax Debtor

Not surprisingly, tax debtors may assign themselves into bankruptcy as a result of their tax debts. Unfortunately, this may leave a recipient/transferee fully exposed to assessment under ITA subsection 160(1) and/or ETA subsection 325(1).

In *The Queen v. Heavyside*,[33] a husband transferred his interest in a property to his wife for no consideration. The wife was assessed, pursuant to ITA subsection 160(1),

29 2000 DTC 2084 (TCC).

30 If this is correct, it follows that the onus would be on the minister to show that a misrepresentation (as outlined in ITA subparagraph 152(4)(a)(i)) had occurred, thereby allowing the CRA to issue a reassessment outside the normal reassessment period.

31 See also the decision in *Smitlener v. The Queen*, 2009 TCC 268, where the appellant challenged the underlying assessment of his mother (the tax debtor), because she had been assessed on a sale of property on the basis that the sale was on income account. The appellant was allowed to allege that his mother should have been assessed on capital account, thereby reducing her tax debt and, in turn, the appellant's liability.

32 *Gaucher*, supra note 28, at paragraph 9.

33 97 DTC 5026 (FCA).

for the fair market value of the property interest, since her husband's tax debt exceeded that amount. The issue before the court was that the assessment had been issued, not just after the husband had made an assignment in bankruptcy, but actually after his discharge from bankruptcy.

The wife successfully appealed the assessment to the Tax Court,[34] on the basis that her joint and several liability as a transferee existed only to the extent that her husband, the transferor, remained liable to pay the income tax in question, and that since her bankrupt husband was no longer liable because of his discharge, there was no longer any tax debt for which she could be liable.

The Federal Court of Appeal overturned the decision of the Tax Court, finding that once the conditions for an ITA subsection 160(1) assessment were met, the wife became liable at the time of the transfer for the amount assessed. Furthermore, the assessment (and the tax liability arising from it) "had a life of its own and survived the eventual extinguishment through bankruptcy . . . of her husband's own tax liability."[35]

It is for this reason that before a taxpayer decides to pursue bankruptcy, it is important to consider the potential exposure of non-arm's-length parties to assessment under ITA subsection 160(1) and/or ETA subsection 325(1).

Condition 3: The Parties Must Be Non-Arm's-Length

The non-arm's-length condition is normally self-evident and will not be further explored in this article.

Condition 2: There Must Be a Transfer of Property and Condition 4: The Fair Market Value of the Property Transferred Must Exceed the Fair Market Value of the Consideration Given by the Transferee

Conditions 2 and 4 form the basis for most disputes involving assessment under ITA subsection 160(1) and/or ETA subsection 325(1). Typically, the taxpayer's objection to the assessment in such cases is based on one or more of the following arguments:

- A transfer did not occur (usually on the basis that the transferor retained the beneficial interest in the property transferred).
- The CRA erred in determining the fair market value of the property transferred.
- The CRA failed to recognize the fair market value of the consideration given by the recipient.

34 *Heavyside v. The Queen*, [1996] 98 DTC 2211 (TCC).

35 *Heavyside*, supra note 33, at 5028. See also *Wannan*, supra note 20, at paragraph 12.

Was There a Transfer?

Normally, a transfer raising the risk of assessment under ITA subsection 160(1) and/or ETA subsection 325(1) will arise from a gift from the tax debtor to the recipient. However, if that gift has not been validly accepted, there cannot be a transfer.

In *Leclair v. The Queen*,[36] the tax debtor transferred land to his daughter without her knowledge. The recipient was only made aware of the land transfer when she received the ITA subsection 160(1) assessment. The Tax Court found that since the recipient had never accepted the gift, a valid transfer had not taken place, and therefore there was no basis for the assessment. In finding that the gift had not been accepted, the court noted that the recipient had never incurred any expenses in respect of the property, and furthermore, that she had returned the property to her father immediately upon becoming aware of the initial transfer.

The *Leclair* decision serves as a reminder to advisers who may be acting in respect of a property transfer (such as land) to query the parties as to whether there is any risk that the transferor may be liable for a tax debt.

The CRA and the Department of Justice have relied heavily on *Livingston*[37] in supporting assessments under ITA subsection 160(1) and/or ETA subsection 325(1), and in disputing defences raised by taxpayers in relation to the "sufficient consideration" or "no beneficial ownership" arguments. The decision is therefore worthy of a detailed review—including discussion of some recent case law that may have tempered its applicability.

In *Livingston*, the recipient (Ms. Livingston) was a friend of the tax debtor (Ms. Davies). Ms. Davies had been avoiding the collection attempts of the CRA for some time, by continually moving her bank and brokerage accounts. Ms. Livingston was aware of this when she agreed to open a personal bank account, in her name only, to assist Ms. Davies in thwarting the CRA's collection action.

The bank account was solely used by Ms. Davies; she had the only bank card and received all bank statements directly, and the Ms. Livingston provided her with blank signed cheques. Furthermore, Ms. Davies deposited all funds into the account.

When Ms. Davies declared bankruptcy, she did not declare that she had any beneficial interest in the bank account.

Subsequent to Ms. Davies bankruptcy, Ms. Livingston was assessed for *all* funds that were deposited into the account—not just the balance at the time of the assessment.

Ms. Livingston successfully appealed the assessment to the Tax Court on the basis of condition four—that the provision of the bank card and cheques to Ms. Davies constituted sufficient consideration for the transfer of funds.[38] However, that finding was overturned by the Federal Court of Appeal. Sexton JA, writing for the court,

36 2011 TCC 323.

37 *Livingston*, supra note 5.

38 *Livingston v. The Queen*, 2007 TCC 303.

found that there was nothing left with Ms. Davies that was equivalent to the property that had been transferred to Ms. Livingston (property that the CRA could have collected upon). He further commented:

> The Tax Court Judge erred in law by failing to conduct *any* analysis of the fair market value of the consideration. He simply concluded that it was "adequate." I fail to see how the fair market value of the consideration, if any did exist, would be equivalent to the funds deposited. Why would Ms. Davies give an amount of money to the respondent in consideration for the ability to withdraw the money, when the respondent retains the power to take the money? No prudent, arm's length purchaser not motivated by the prospect of evading collection of their tax debt would pay the full value of funds in exchange for the right of access that Ms. Davies received.[39]

While Ms. Livingston attempted to further argue that the deposit of funds only divested Ms. Davies of legal title to the funds, with beneficial title remaining with Ms. Davies, the Federal Court of Appeal disagreed. Sexton JA found that, given the purpose of ITA subsection 160(1) (to prevent a tax debtor from transferring property to thwart the CRA's collection efforts),

> the intention of the parties to defraud the CRA as a creditor can be of relevance in gauging the adequacy of the consideration given. However, I do not wish to be taken as suggesting as [sic] there must be an intention to defraud the CRA in order for subsection 160(1) to apply. The provision can apply to a transferee of property who has no intention to assist the primary tax debtor to avoid the payment of tax: see *Wannan v. Canada*, 2003 FCA 423 at paragraph 3.[40]

And further,

> [t]he deposit of funds into another person's account constitutes a transfer of property.[41]

The above statement of the Federal Court of Appeal has formed the basis for some rather harsh assessments being issued by the CRA. An example is the decision in *Gambino v. The Queen*.[42]

In *Gambino*, the 78-year-old appellant was assessed by the CRA, pursuant to ITA subsection 160(1), in respect of seven cheques, each in the amount of $1,500, that she cashed on behalf of her son (who was too ill to cash them himself). In all but one of the cases, Ms. Gambino returned the full amount of $1,500 to her son the same day; in that one case, she first applied $500 to a loan that she had made to her son and then returned the remaining $1,000.

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39 *Livingston*, supra note 5, at paragraph 28.

40 Ibid., at paragraph 19.

41 Ibid., at paragraph 21.

42 2008 TCC 601.

While the Crown conceded that Ms. Gambino never took beneficial ownership of the funds, it relied heavily on paragraph 21 of the decision in *Livingston* (a portion of which is reproduced above), arguing that by giving the endorsed cheque to his mother, Mr. Gambino transferred to her the right to require the payer's bank to pay all of the funds to the bearer. Thus, applying the same analysis as the Federal Court of Appeal applied to an actual deposit of funds in *Livingston*, the Crown contended that the transaction should be regarded as a transfer of valuable property to Ms. Gambino by her son at the time he gave her his endorsed cheque.

The Tax Court noted, in respect of *Livingston*:

> In that case, a scheme was developed with the intention to hide assets in order to avoid creditors and the parties had in fact conspired to prejudice CRA. While this is not a precondition to the application of section 160, the Court of Appeal described it as a "crucial fact" for purposes of the *Livingston* appeal. That knowledge and intention was not present here. The Court in *Livingston* says at paragraph 19 that such knowledge and intention can be relevant in valuing the adequacy of the consideration given.[43]

The court went further. In reversing the assessment, it found the following:

- The CRA could not provide any evidence of further prejudice from Ms. Gambino's cashing her son's cheques, as opposed to his personally cashing the cheques.
- The funds never went into Ms. Gambino's bank account.
- The Crown's argument, taken to its extreme, would mean that the CRA could assess Ms. Gambino pursuant to ITA subsection 160(1) even if she had used the funds to make a payment to the CRA on her son's behalf.
- Ms. Gambino had committed to return the funds when she received the cheques from her son. Since she did not view them as a gift, this provided the necessary consideration.

Gambino illustrates the specific facts necessary, and the judicial effort that must be undertaken, to avoid the harsh results that can flow from *Livingston*.

The Federal Court of Appeal, in more recent decisions, has provided some potential clarity as to the applicability of the principles articulated in *Livingston*.

In *Canada v. 9101-2310 Québec Inc.*,[44] the tax debtor owed money to a number of creditors. He was concerned that funds he had received as insurance proceeds would be immediately seized by one of the creditors if he deposited them into a personal account. The tax debtor's friend, *aware of the tax debtor's creditor problems*, offered to deposit the funds into a bank account of a corporation that the friend owned. The tax debtor had no other interest in the corporation.

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43 Ibid., at paragraph 24.

44 2013 FCA 241.

The Tax Court had vacated the assessment on the ground that no transfer had taken place, because the parties had entered into a written agreement to the effect that the funds still belonged to the tax debtor—despite the deposit into the corporation's account.[45] In fact, the funds were withdrawn from the corporation's account at the direction of the tax debtor, and used to pay off certain debts and cover other expenses of the tax debtor.

While the Federal Court of Appeal ultimately overturned the Tax Court's decision (in large part on the basis of certain civil-law principles that were applicable in Quebec, where the transfers took place), its comments in obiter in respect of the common law are of particular note. Noël JA wrote, on behalf of the court:

> I think it is nevertheless useful to comment briefly on the impact of this Court's decision in *Livingston* on the case at hand, given the controversy that *Livingston* has raised, as evidenced by the reasons of the TCC judge.[46]

Noël JA began by noting that the common law recognized two elements of ownership—legal and beneficial—with the beneficial owner being the "real" owner of the property. He then turned to the *Livingston* decision, and pointed out that the findings in that decision flowed directly from the fact that the parties in that case had worked together to thwart the CRA's collection actions:

> Relying on a contextual interpretation of subsection 160(1), the Court concluded that, in the circumstances, it was enough that the tax debtor had transferred legal title in the deposited funds to Ms. Livingston for subsection 160(1) to apply. *Even though this provision applies without regard to the intention of the parties, the Court found the fact that Ms. Livingston and the tax debtor had conspired in order to deceive the tax authorities to be "crucial"* (*Livingston* at paragraph 12).
>
> The crux of . . . the Court's reasons for rejecting that argument emerges from the following paragraphs (*Livingston* at paragraphs 20, 21 and 22): . . .
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>> [21] The deposit of funds into another person's account constitutes a transfer of property. . . . *The property transferred was the right [of Ms. Livingston] to require the bank to release all the funds to [Ms. Livingston]. The value of the right was the total value of the funds.*
>> [22] *In addition, there is a transfer of property for the purposes of section 160 even when beneficial ownership has not been transferred.* Subsection 160(1) applies to any transfer of property—"by means of a trust or by any other means whatever." Thus, subsection 160(1) categorizes a transfer to a trust as a transfer of property. *Certainly, even where the transferor is the beneficiary under the trust, nevertheless, legal title has been transferred to the trustee. Obviously, this constitutes a transfer of property for the purposes of subsection 160(1) which, after all, is designed, inter alia, to prevent the transferor from hiding his or her assets, including behind the veil of a trust,*

45 2012 TCC 365.

46 *9101-2310 Québec Inc.*, supra note 44, at paragraph 42.

> *in order to prevent the [Canada Revenue Agency] from attaching the asset*. Therefore it is unnecessary to consider the respondent's argument that beneficial title to the funds remained with Ms. Davies.[47]

Noël JA then clarified the principles of *Livingston*, as follows:

> The rule to be gleaned from this decision, as I understand it, is that the transfer of legal title in a sum of money may give rise to a transfer for the purposes of subsection 160(1) where it is intended to conceal the fact that the tax debtor is the beneficial owner of this sum and thwart the tax authorities' collection efforts.[48]

Thus, the Federal Court of Appeal appears to have pulled back on the applicability of *Livingston*, particularly where it can be shown that all that has been transferred is legal title, with beneficial interest remaining with the tax debtor/transferor. However, the latter defence will not succeed where it can be shown (as was the case in *Livingston*) that the recipient/transferee was a willing participant in thwarting the tax collection efforts of the CRA.[49]

The above proposition is further supported by *Canada v. Lemire*.[50] In that case, the Federal Court of Appeal found that the recipient had allowed the tax debtor (who was her spouse) to deposit cheques into her account. The recipient returned the funds directly to the tax debtor almost immediately after every such deposit. The accepted evidence was that the recipient was not aware that the tax debtor had any creditors; rather, their system had arisen from the fact that the tax debtor had a bank hold of several days on cheques deposited to his account, whereas his spouse did not. While the decision relied on civil-law principles, the court cited the decision in *9101-2310 Québec Inc.* in finding that ownership of the funds deposited always remained with the tax debtor.[51] The court further noted that while the recipient had a right to withdraw funds from the bank account for her own purposes, that right was of no value as a result of her obligation to immediately remit the funds to the tax debtor. Finally, while this was not specifically mentioned in the reasons for judgment, the court may have been influenced by the fact that the recipient stopped the practice of using her bank account immediately upon being advised during an audit

47 Ibid., at paragraphs 51-52 (emphasis added).

48 Ibid., at paragraph 53.

49 This last condition would still make for difficult decisions, such as that in *Brauer v. The Queen*, 2012 TCC 382, where the recipient (mother) opened a bank account in her name and gave the tax debtor (her son) access to it. The account was opened by the mother to allow her son to deposit his paycheques and receive the funds while avoiding CRA collection action. Without finding that there existed a binding legal obligation (as opposed to a moral obligation) not to access the funds, there was no valid consideration. As a result, the mother became liable for over 18 months of her son's deposits. See also *Pickard v. The Queen*, 2010 TCC 535.

50 2013 FCA 242.

51 In a case with similar facts, *Lapierre v. The Queen*, 2012 TCC 299, the court found that property had not been transferred for the purposes of an ITA subsection 160(1) assessment.

that it carried a risk to her, thereby supporting a finding that she was not a willing participant in thwarting the CRA's tax collection efforts.

Fair Market Value of the Property

In my experience, when dealing with assessments under ITA subsection 160(1) and ETA subsection 325(1), fair market value of the property transferred is often the only defence that remains for the recipient. Practically speaking, this arises because

- there is often no dispute that the transferor owed a tax debt, or as to the amount of the debt;
- there is normally a clear transfer of property,[52] and even relying on the Federal Court of Appeal's clarification of the principles in *Livingston*, the recipient is often fully aware of the desire to avoid creditors;
- the parties are usually related and therefore are non-arm's-length; or
- the transfer usually takes place by way of a gift, with no consideration being given.

The following example illustrates a situation where the valuation of the property transferred determines the outcome of a disputed assessment:

> *Example 3*
>
> An uncle transfers two pieces of adjacent land to his nephews by way of gift.
>
> Nephew 1 receives the southern piece, which has road access, and nephew 2 (the brother of nephew 1) receives the northern, land-locked piece.
>
> Nephew 2 does not want the land and transfers it to nephew 1 for declared consideration of $1.00. The Nephews are obligated, pursuant to the land transfer document, to value the piece of land. They guess, and list the value as $20,000.
>
> Unbeknownst to nephew 1, at the time of the transfer, nephew 2 has a tax debt of more than $20,000 owing to the CRA.
>
> The CRA, upon becoming aware of the land transfer, proposes to assess nephew 1 under ITA subsection 160(1) in the amount of $19,999.
>
> Nephew 1, however, is able to obtain a land appraisal showing that the northern portion has a fair market value of only $3,000. The CRA accepts this valuation, leaving nephew 1 with a tax bill of $2,999.

Many of the transfers that result in ITA subsection 160(1)/ETA subsection 325(1) assessments involve the transfer of a joint interest in property (such as a family home) from one joint interest holder to another. Normally, this would raise a valuation issue, given that the market would not normally pay 50 percent of the total value of a property for a 50 percent interest in it. ITA section 160 and ETA section 325 deem the interest to be equal to its portion of the fair market value of the entire

52 I note that these transfers often occur before any professional advice is sought.

property.[53] Accordingly, a 50 percent joint interest will be valued, for the purposes of an assessment under these provisions, at 50 percent of the fair market value of the entire property.

Fair Market Value of the Consideration

If there is any ability to argue that consideration has been provided by the recipient, this may reduce the liability under ITA subsection 160(1)/ETA subsection 325(1). For example, in *Miller v. The Queen*,[54] the court found that a commitment by the recipient to use funds in a certain manner constituted consideration for the purposes of an ITA subsection 160(1) assessment.[55]

In *Miller*, the husband (a dentist), prior to his bankruptcy in 2000, had transferred significant funds to his wife, during a period when he owed a tax debt to the CRA. The wife's defence flowed from the fact that her husband, who was facing significant financial pressure at the time, agreed to transfer funds into the wife's personal bank account, with the wife then agreeing to use the funds to pay not only expenses of her husband's dental practice, but also household expenses. The Tax Court accepted the defence, finding as follows:

> In my opinion, the Appellant gave *consideration* in return for the receipt of the subject funds from her husband. The *consideration* was her commitment to [her husband] to utilize the funds to pay expenses of [her husband's] dental practice and also to pay certain expenses relating to [her husband's] own residential accommodation.
>
> I have also concluded on the evidence that was before me that the Appellant had a legal obligation, not just a moral obligation, to make the payments described above from the Bank Account.[56]

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53 See ITA subsection 160(3.1) and ETA subsection 325(1.1).

54 2011 TCC 412.

55 See also the decision in *Colborne v. The Queen*, 2012 TCC 198, where the court found that adequate consideration had been given to reverse an ITA subsection 160(1) assessment. In that decision, the tax debtor's corporation operated a "white label" automated teller machine (ATM), which was independent of any bank. The ATM allowed individuals to withdraw money from their bank accounts, with an additional transaction fee being charged by the corporation. Owing to financial difficulties, the corporation was unable to access credit to keep the ATM fully loaded with cash. The corporation therefore issued cheques to the recipient (who had a $2,000 overdraft limit on her bank account). The recipient would immediately withdraw the funds, accessing her overdraft, and the funds would then be used to supply the ATM. Within 24 hours, the funds withdrawn from the ATM (plus the transaction fee) were returned electronically to the bank account of the corporation and used to clear out the overdraft on the recipient's bank account. The process was repeated multiple times, leading to an $85,000 ITA subsection 160(1) assessment. The court, seeing itself as being bound by the principles in *Livingston*, still found that there was a transfer of property to the recipient. However, it further found that a valid legal contract existed between the debtor corporation and the recipient, such that consideration equal to the value of the funds deposited was given by the recipient. Accordingly, the subsection 160(1) assessment was vacated.

56 *Miller*, supra note 54, at paragraphs 29-30 (emphasis in original).

Interestingly, while this is not entirely clear from the reasons for judgment, it appears that the Tax Court only accepted consideration equal to the amount of *business* expenses paid during the period when deposits were made to the bank account.[57]

In *Cohen v. The Queen*,[58] consideration was provided through the forgiveness of debt. In that case, the husband and wife had agreed to contribute equally to all household expenses, including the purchase of a jointly owned home. The husband was never able to keep up his share of the expenses and as a result became indebted to his wife. The couple kept a rough record of the indebtedness, and the husband executed a promissory note in favour of his wife. Ultimately, the husband agreed to transfer his 50 percent in the home to his wife, triggering an ITA subsection 160(1) assessment.

Even though the property transfer documentation, including a sworn affidavit, indicated that consideration for the transfer was nil, the court found that sufficient consideration to thwart the subsection 160(1) assessment did exist, that consideration being the discharge of the husband's debt.[59]

It should be noted that the valuation of both the property transferred and the consideration received is determined *as at the time of the transfer*. For example, in *Clause v. The Queen*,[60] the Tax Court disregarded the wife's argument that a payment she had made toward her husband's bankruptcy proposal, four years after a transfer of the property that triggered assessments under ITA subsection 160(1) and ETA subsection 325(1), should be viewed as consideration to reduce the assessments. The court found no evidence that the payment was contemplated *at the time* of the transfer. This shows the importance of documenting, if possible, any consideration that has been, or will be, paid as a result of a property transfer, and of noting that delayed consideration may raise difficulties in retrospectively determining its value at the time of the transfer. Further, in the case where debt is extinguished as consideration for the transfer, proper documentation and recognition of the debt extinguishment are key.

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57 A case with similar facts is *Bragg-Smith v. The Queen*, 2012 TCC 252, where the recipient received $43,000 from her tax-debtor father and was assessed for that amount pursuant to ITA subsection 160(1). The court found that consideration of $32,000 was paid in that the recipient had agreed to, and did, pay a receivable in the amount owed by her father (since her father's accounts were frozen by the CRA) in exchange for receiving the $43,000. The subsection 160(1) assessment was reduced accordingly.

58 2008 TCC 550.

59 See also the decision in *Martin v. The Queen*, 2013 TCC 38, where the value of the wife's unpaid work for her late husband's medical practice, and unpaid rent for a property used as the premises of the medical practice, was sufficient consideration to vacate an ITA subsection 160(1) assessment. Query, however, whether the wife would now be exposed to tax liability for failing to report such income.

60 2010 TCC 410.

OTHER ISSUES

There are a number of other issues that should be reviewed when considering the applicability of ITA subsection 160(1) and ETA subsection 325(1).

Joint Assets

Given that in most situations transfers raising the risk of assessment under ITA subsection 160(1) and/or ETA subsection 325(1) take place within a family, it must be recognized that such assessments may expose further family assets (owned by the transferee/recipient) to CRA collection action. Normally, jointly held assets (whether they be financial, property, or even household goods) held in part by a tax debtor cannot be easily garnished, seized, and/or sold by the CRA, given the non-debtor's interest in the property. However, the effect of an ITA subsection 160(1)/ETA subsection 325(1) assessment is that the jointly held assets are now fully exposed to collection since both owners of the property have become debtors of the CRA.

Multiple Transfers

ITA subsection 160(1), and arguably ETA subsection 325(1),[61] can apply to multiple transfers even if the CRA does not pursue each step of the transfer. For example, if tax debtor A transfers an asset to non-arm's-length recipient B for insufficient consideration, B is liable pursuant to ITA subsection 160(1). However, if B then transfers the asset to recipient C (once again on a non-arm's-length transfer for insufficient consideration), C becomes liable pursuant to subsection 160(1), because B has become a tax debtor—even if the CRA has never issued a subsection 160(1) assessment against B. This example shows the rather harsh nature of these provisions, since C may not be aware of any debt on the part of A (or, for that matter, be aware of the prior transfer between A and B), and with B not needing to be assessed, C can be an innocent target for collection. Potentially even worse, if the CRA does ultimately assess B under subsection 160(1), B will no longer be in possession of the original asset to fund the payment of the tax liability.

Interest

ITA subsection 160(1) was amended in 2013, for assessments made after December 20, 2002, to clarify that not only is the recipient of property liable for the interest owing by the tax debtor as of the date of the assessment, but the assessment will now accrue interest on its own.[62] Before this amendment came into force, the CRA did not accrue any additional interest on subsection 160(1) assessments. This may have

61 See *Jurak v. The Queen*, 2003 DTC 557 (TCC); aff'd. 2003 DTC 5419 (FCA).

62 ITA subparagraph 160(1)(e)(ii), as amended by SC 2013, c. 34, section 313(1). Similar amendments were not made to the provisions of the ETA; however, Sherman, supra note 27, notes that, arguably, the wording of ETA subsection 280(1) is broad enough to require payment of interest and penalty on an amount assessed pursuant to ETA subsection 325(1).

given taxpayers an incentive to object to such assessments, since there was no risk of interest accruing during the objection/appeal process.

Limitation Period

ITA subsection 160(1) and ETA subsection 325(1) are not subject to any statutory limitation period in respect of an assessment of the recipient.[63] As the Supreme Court of Canada noted in *Canada v. Addison & Leyen Ltd.*, citing Rothstein JA (when he was a member of the Federal Court of Appeal),

> [w]hile . . . subsection 160(1) may be considered a harsh collection remedy, it is also narrowly targeted. It only affects transfers of property to persons in specified relationships or capacities and only when the transfer is for less than fair market value. Having regard to the application of subsection 160(1) in specific and limited circumstances, Parliament's intent is not obscure. Parliament intended that the Minister be able to recover amounts transferred in these limited circumstances for the purpose of satisfying the tax liability of the primary taxpayer transferor. The circumstances of such transactions mak[e] it clear that Parliament intended that there be no applicable limitation period and no other condition on when the Minister might assess.[64]

Given the lack of any limitation period and the fact that an assessment under ITA subsection 160(1) or ETA subsection 325(1) is based on the fair market value of the property *at the time of the transfer*, the recipient can face a significant financial liability while no longer in possession of an asset reflecting that value. The following example illustrates this point.

> *Example 4*
>
> A grandfather purchases a new car for each of his grandchildren as a gift.
>
> At the time of the gift, but unbeknownst to the grandchildren, the grandfather has a significant debt owing to the CRA.
>
> Many years later, the CRA assesses the grandchildren for the value of the vehicles, which by this time have a current fair market value that is significantly less than the original sale price.
>
> Ultimately, each of the grandchildren is left with an ITA subsection 160(1) assessment based on the sale value of the vehicle when it was purchased by the grandfather.[65]

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63 ITA subsection 160(2) and ETA subsection 325(2).

64 2007 SCC 33, at paragraph 9, quoting *Addison & Leyen Ltd.*, supra note 26, at paragraph 92. If it is any consolation, the CRA has confirmed that a subsequent reassessment of an ITA subsection 160(1) assessment would be subject to the normal reassessment period. See CRA document no. 2010-0357191I7, March 29, 2010.

65 If the grandfather had simply kept the vehicles, the CRA's remedy in respect of those assets would have been to seize them and realize on their now depreciated value. These provisions, in essence, provide a windfall to the CRA in its collection actions.

The Risk of Double Taxation

The CRA has stated that a shareholder who has been assessed under ITA subsection 15(1) can also be assessed under ITA subsection 160(1) or ETA subsection 325(1).[66] In this respect, the CRA relies on the decision in *Bleau v. The Queen*,[67] where the Tax Court found that at the time of the shareholder appropriation, the corporation's corporate tax was unpaid, and thereby concluded that subsection 160(1) was applicable to the amount appropriated, notwithstanding that the same amounts had already been taxed under the provisions of ITA subsections 15(1) and (2).

Family-Law Issues

ITA subsection 160(4) and ETA subsection 325(4) provide that the provisions of subsections 160(1) and 325(1), respectively, do not apply where a taxpayer has transferred property to a spouse or common-law partner 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 taxpayer and his or her spouse or common-law partner were separated and living apart as a result of the breakdown of the marriage or common-law relationship.

Dividends

The courts have repeatedly held that a dividend paid by a corporation to a non-arm's-length shareholder at the time that the corporation owes taxes will create a basis for a valid ITA subsection 160(1) assessment,[68] unless it can be shown that the dividends constitute the repayment of amounts otherwise owing (such as shareholder loans).[69] Accordingly, where a company is in financial distress but has retained earnings, it may be advisable for the company to pay salaries instead of dividends, in order to avoid the possibility of a future assessment under ITA subsection 160(1) or ETA subsection 325(1) in the event that the company is unable to satisfy its obligations under the tax law.[70]

66 CRA document no. 2010-0354691I7, January 27, 2010.

67 2006 TCC 36; aff'd. 2007 FCA 61.

68 See, for example, *Algoa Trust et al. v. The Queen*, 93 DTC 405 (TCC); *Hennig v. The Queen*, 2012 TCC 141; and *2753-1359 Québec Inc. v. Canada*, 2010 FCA 32.

69 See, for example, *Alimoradi v. The Queen*, 2013 TCC 204.

70 Timothy Clarke, "Tax Litigation Issues Relevant to Small and Medium-Sized Businesses," in *2012 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2012), 7:1-17, at 7:14-15.

CONCLUSION

ITA subsection 160(1) and ETA subsection 325(1) are, indeed, draconian provisions granting the CRA significant collection powers. The defences, as discussed above, are limited, but an adviser should consider the following factors where a client is faced with such an assessment:

- the current balance of the tax debtor's liability, to ensure that the CRA has properly calculated the liability of the recipient/transferee;
- whether there is any basis on which the underlying tax liability of the tax debtor may be challenged;
- whether a transfer in fact occurred, by determining whether the gift was accepted or no beneficial ownership in the property was actually transferred;
- in the case of transfers of money, whether the recipient was aware of any attempt to thwart CRA collection action;
- the fair market value of the property and whether evidence can be gathered to refute the CRA's valuation; and
- whether consideration can be shown to have been given by the recipient at the time of the transfer, and the value of such consideration.

Given the limited defences, it may be just as important to caution a client who is facing tax liability about these provisions, in case the client is contemplating some method of moving or hiding assets in an attempt to frustrate the CRA's collection efforts.