

Colitto: Timing Issues Related to the Collection Provisions of the Income Tax Act

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The Income Tax Act (the “Tax Act”) contains provisions that allow the Minister of National Revenue (the “Minister”) to collect amounts owed by one taxpayer under the Tax Act from another person. Under paragraph 160(1)(e) of the *Tax Act*, where a taxpayer has transferred property to a non-arm’s length person for less than fair market value consideration, the transferor and transferee are jointly and severally liable for taxes that the transferor otherwise owes.

Section 227.1 of the Tax Act provides that directors of a corporation are jointly and severally liable with the corporation if the corporation fails to deduct, withhold, or remit tax as required by certain provisions of the Tax Act. Importantly, the director’s liability is limited to situations in which the corporation is dissolved, bankrupt, or an execution for the corporation’s tax debt has been returned unsatisfied.

In *Colitto v The Queen*, 2019 TCC 88, the Tax Court of Canada examined when the cascading application of these provisions applies to a person who receives property at less than fair market value from a director of a corporation with an uncollected tax liability. The Tax Court held that the liability of such recipient only applies after the Minister has satisfied the preconditions of section 227.1.

In 2008, the taxpayer’s spouse transferred his 50% interest in two properties to the taxpayer for nominal consideration, which resulted in a total benefit to the taxpayer of over \$200,000. In the same year, a corporation of which the taxpayer’s spouse was a director failed to remit source deductions. In 2009, a certificate for the corporation’s tax debt was registered in the Federal Court. In 2011, after collection of the corporation’s tax debt was unsatisfied, the Minister assessed the taxpayer’s spouse under section 227.1. The taxpayer was not assessed under section 160 until 2016.

The only issue before the Tax Court was the timing of the taxpayer’s spouse’s liability for the corporation’s failure to remit its source deductions, and how that timing related to the taxpayer’s liability in respect of the transfers of property from the taxpayer’s spouse. The parties had agreed that: the taxpayer’s spouse was a director at the time the corporation failed to remit; he did not exercise due diligence to prevent such failure; and no limitation period defence was available.

The Tax Court undertook a textual, contextual and purposive analysis of section 227.1 and found that director’s liability does not arise unless and until the relevant preconditions are satisfied. Importantly, the Tax Court held that “there is no language in section 227.1 which provides that the liability should be applied retroactively once it arises” (at paragraph 71). As a result, the Tax Court held that the taxpayer’s spouse was not liable as a director until 2011, when execution of the corporation’s tax debt was returned unsatisfied, and not in 2008 when the corporation failed to remit. Therefore, the cascading assessments against the taxpayer were vacated.

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The Minister has appealed the decision. If the decision is upheld by the Federal Court of Appeal, it will be interesting to see if collection efforts are accelerated or the government chooses to address the issue through legislative amendments.

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