TAX LETTER

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CHARITABLE ORGANIZATIONS AND THE DISBURSEMENT QUOTA

TAX-FREE DEATH BENEFITS TO EMPLOYEES

WHAT IF YOU DISAGREE WITH THE CRA?

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AROUND THE COURTS

CHARITABLE ORGANIZATIONS AND THE DISBURSEMENT QUOTA

Are you on the board of a registered charity, or involved with running a registered charity?

If you are, you need to ensure that the charity meets its "**disbursement quota**" each year. The rules have changed effective 2009.

The disbursement quota is designed to ensure that charities spend most of their income, and some of their capital, on genuine, active charitable work. This is because donors to the charity receive generous tax credits for donations, so that the income tax system is in effect subsidizing the charity. The Canada Revenue Agency considers that fundraising activities and most administrative expenses do *not* qualify as charitable activities for purposes of the disbursement quota. However, transfers of funds to other charities do qualify in most cases.

If the charity does not meet the disbursement quota, its charitable registration can be revoked. If this happens, the charity cannot issue tax receipts for further donations. It also must transfer all of its assets to another registered charity within a year, failing which its assets are effectively forfeited to the government (via a 100% tax on its assets). Thus, compliance with the disbursement quota is very important. (A failure to meet the quota in one year can be remedied the next year by having a "disbursement excess", however.)

For many years, the disbursement quota has been **80% of donations received**, subject to some exceptions and adjustments.

Under changes to the Income Tax Act enacted in 2004, the disbursement quota also includes **3.5% of the capital of the charity** (if the charity's investment assets exceed $25,000). In other words, a charity that holds significant investments or other assets must spend 3.5% per year of that capital, in addition to the 80% of its donation revenues, to stay within the disbursement quota. For charities that have been registered since before March 23, 2004, **this rule first takes effect with the 2009 year,** meaning that the charity must meet this disbursement requirement for 2009. There are some exceptions, notably for "enduring property", which includes property donated to the charity on condition that it be kept for at least 10 years, as well as property received as a bequest (in a deceased person's will).

The CRA sends out annual notices informing charities of their disbursement quota requirement. To calculate the disbursement quota see Form T1259, available at www.cra-arc.gc.ca/forms. See also the "Disbursement Quota Checklist" at www.cra-arc.gc.ca/tx/chrts/chcklsts/dq-eng.html; and "Annual spending requirement", at www.cra-arc.gc.ca/tx/chrts/prtng/spndng.

TAX-FREE DEATH BENEFITS TO EMPLOYEES

Most benefits provided by an employer to an employee are taxable benefits for income tax purposes.

On an employee's death, however, the first **$10,000** of death benefits paid by the employer to the employee's spouse or children is tax-free.

If the payments go to more than one person (e.g., both spouse and children), the spouse gets the exemption first. A common-law spouse qualifies for this exemption.

Even though the benefit is tax-free, the expense is normally deductible to the employer as a routine expense of doing business, especially if the death benefit is something the employer has agreed to pay in its contract of employment with the employee.

WHAT IF YOU DISAGREE WITH THE CRA?

What do you do if the Canada Revenue Agency issues you an income tax or GST Notice of Assessment (or Reassessment), and you believe the Agency is wrong and that you should not be paying so much?

The CRA's role

As you may know, the CRA doesn't create the law. The rules for our income tax system are set out in the Income Tax Act, as amended by Parliament every year. Similarly, the GST rules are enacted in the Excise Tax Act.

The CRA's job is to administer and enforce the system. As such, **the CRA is bound by the law**. However, sometimes the Agency's interpretation of the law is different from that of taxpayers, and can successfully be chal-

lenged. More commonly, the Agency assessor or auditor may simply not have understood the facts of your case.

Objection (appealing within the Canada Revenue Agency)

The first step is to make sure that you **understand the rules** of the Income Tax Act as they apply to your problem. Sometimes, even though the rules seem unfair, they are being correctly applied. If the rules are clear, then no matter how much you dislike paying the extra tax, you may have no choice.

Don't hesitate to get professional advice at this stage. An hour spent with an expert tax lawyer or accountant will be well worth it, if as a result you can know whether the assessment is simply a clear application of the law, or whether you have a realistic chance on objection or appeal.

The next step is to contact the CRA and request an adjustment. Sometimes a phone call or meeting with Agency officials can help iron out your problem and clarify the issues, though you may wish to put your request in writing. You can also request adjustments online using www.cra-arc.gc.ca/myaccount.

You will have to file a **Notice of Objection** (see CRA Form T400A, for income tax objections) before the deadline for doing so expires. The deadline is **90 days** from the date of mailing of the notice of assessment or reassessment to which you are objecting (or, for personal tax returns, one year from the original April 30 or June 15 deadline for filing the return in question, if that is later). The date showing on the Notice of Assessment is normally presumed to be the date of mailing (*Income Tax Act*, subsection 244(14)).

Even if you are negotiating a solution and Agency officials have agreed orally or in writing to your position, **you *must* file the Notice of Objection if the deadline is approaching** and no reassessment has been issued to your liking. Otherwise you lose your legal right to appeal. The CRA's promise to correct an assessment will not be binding until the reassessment is actually issued.

Within about 6-12 months after you file the Notice of Objection, your case will be reviewed by an **Appeals Officer**. This officer is internal to the CRA but is independent of the Audit section which normally issues the reassessment. Thus you are assured that your case is being given a "fresh look" by someone who has no preconceptions as to the result. In fact, under the

Agency's administrative policy, the Appeals Officer is not even supposed to talk to or meet with the auditor without providing you with a copy of the minutes of any such discussion.

The Appeals Officer is required by CRA administrative policy to give you a copy of the auditor's working papers and other documents in the file (except confidential material relating to third parties, or any legal advice the CRA has received that is protected by solicitor-client privilege).

You can also file a request for a copy of the entire file under the *Privacy Act* by writing to the Access to Information and Privacy Office of the CRA (call 613-688-9064 for information about this procedure). It can be very useful to get copies of all correspondence, memos, email and analysis engaged in by the auditor and other persons the auditor may have consulted. (If your business is incorporated, so that the taxpayer that was assessed is a corporation, the same information is available, for a small fee, under the *Access to Information Act* rather than the *Privacy Act*.)

You can meet with the Appeals Officer and try to convince him or her of the correctness of your position, or you can make your case in writing. The procedure is very casual; there is no formal "hearing".

If the Appeals Officer agrees with you, the reassessment will be "vacated", or will be "varied" to reflect your position (and a new reassessment issued), and that is the end of the matter. If not, the reassessment will be "confirmed". At this point you have exhausted your routes of appeal within the CRA, and must resort to the courts.

Appealing to the Tax Court

You have **90 days** from the day the confirmation of the reassessment is mailed to you to appeal to the **Tax Court of Canada**. If you miss the deadline, an extension of up to one year may be available, but only if certain conditions are met.

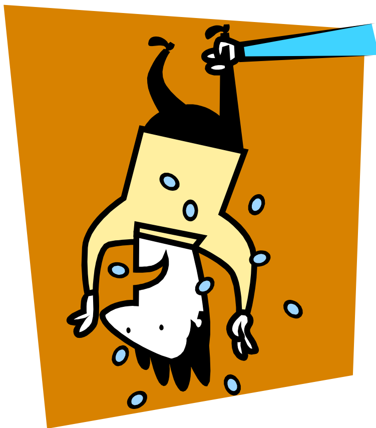
If the amount at stake involves less than $12,000 in total *federal* tax and penalties for any given taxation year, not counting interest, you may choose to use the Tax Court's **Informal Procedure**. (Including provincial tax and interest, this typically covers disputes of up to about $20,000-$25,000 per taxation year assessed.) Otherwise, unless you give up your right to appeal the excess, you are required to use the court's **General Procedure**.

The Informal Procedure is informal in terms of paperwork, but there is still a formal hearing before a judge in a courtroom. In theory, you are sup-

posed to receive a decision within 12 months of filing your appeal, but it often takes somewhat longer.

For the General Procedure, you should retain a lawyer. (Technically, you can act for yourself, but given the complex court rules and procedures involved it is not advisable.) A case under the General Procedure can easily take two years or more to get to trial, and even longer before the judge issues a decision.

Do you pay the balance owing?



While your case is under objection or appeal to the Tax Court, you cannot be forced to pay the balance owing. Interest will continue to accrue on the unpaid balance, however; the current rate is 5%, compounded daily (the rate changes every quarter). This interest is non-deductible.

The CRA has the right to withhold any refunds or rebates (income tax or GST) that you are entitled to, and apply them to the tax debt. Other than such "set-off", however, the CRA cannot take other collection action to enforce payment.

Should you pay anyway?

If you believe that your case is likely to lose, *or* if you have the funds available, it is usually a **good idea to pay the balance**. That will stop the non-deductible interest from accruing in the event you lose. And if you win, you will receive refund interest (currently at a rate of 3% compounded daily) when the overpaid balance is refunded to you.

Paying the balance has no effect on the outcome of the case. Neither the Appeals Officer nor the Tax Court will consider it an admission of liability. In fact, neither the Appeals Officer nor the Tax Court will normally even be aware of whether you have paid or not. Collections and Appeals are quite separate departments within the CRA.

Note that if you have a GST assessment, or an assessment relating to source deductions (such as payroll) which were withheld and not remitted, there are no restrictions on CRA collection action, and the CRA will normally take action to collect the balance even while the assessment is under objection or appeal. (It is possible to get Collections officers to use their discretion to hold off on collection action, if you appear to have a good case and it appears that you will still have assets after the case is resolved.)

Beyond the Tax Court

After the Tax Court of Canada has given its decision, either you or the CRA can appeal to the Federal Court of Appeal. Appeals can only be taken on matters of law; you cannot appeal the judge's findings of fact (such as whether any evidence you gave was credible).

It typically takes about a year from the time an appeal is filed until the Federal Court of Appeal gives its judgement.

In rare cases, an appeal from the Federal Court of Appeal will be heard by the Supreme Court of Canada. That Court accepts appeals only on matters it considers to be of national importance, and typically considers only four or five tax cases a year.

Administrative Appeals — The "Taxpayer Relief Package"

There is one set of rules that are within the CRA's discretion, and for which you cannot file a Notice of Objection or appeal to the Tax Court. These are part of the Agency's **"Taxpayer Relief package."**

The "Taxpayer Relief package" has a number of components. One of them allows the CRA to **reopen your return and issue a reassessment to reduce your taxes for any past year,** going back up to 10 years from when you apply. If, for example, you discover that you neglected to claim a credit or deduction that you could have claimed several years ago, you can apply to the CRA to reassess your return for this purpose. Once 90 days have passed from the original assessment, and one year has passed from the original due date for the return, you cannot file a Notice of Objection and so you cannot force the CRA to do this. But in many cases the Agency will honour your request, particularly where the failure to make the claim was a result of an oversight on your part. (Your request will generally not be allowed if what you are doing is considered to be retroactive tax planning.)

Another element of the Taxpayer Relief package allows the CRA to **waive interest and penalties,** again provided you apply within 10 years of the taxation year from which the interest is calculated. Interest is automatically added to payments of tax or instalments that are not made on time, and is compounded daily. Penalties are also applied in certain cases. Grounds for waiver include:

- a serious illness or accident that prevented you from filing or making a payment on time

- serious emotional or mental distress, such as caused by illness or death in the immediate family
- disasters such as a flood or fire
- civil disturbances or disruptions in services, such as a postal strike
- processing delays that resulted in you not being informed, within a reasonable time, how much was owing
- incorrect information that you received from the CRA
- "financial hardship": your inability to pay the total owing due to the amount of accrued interest.

Note that the CRA cannot waive the amount of *tax* you owe; the waiver applies only to the interest and penalties.

A request for Taxpayer Relief can be made on Form RC4288 (available at www.cra-arc.gc.ca/forms), or simply by writing a letter to your local CRA Tax Services Office. See Information Circular 07-1 for more about the process.

If you are unhappy with the CRA's decision on a "Taxpayer Relief" issue, you can ask for a "Second Level Review", which is undertaken by more senior officials within the CRA. If you are still unhappy with the decision, you can **apply to the Federal Court for "judicial review"** of that decision. This can be done on your own, though it would be wise to consult a lawyer.

However, the Federal Court will normally not substitute its judgment for that of the CRA. It will only grant relief if you can show that the CRA's decision was **unreasonable** — for example, the CRA took irrelevant information into account, or did not act with procedural fairness. Even then, the best the Federal Court will normally do is to send the matter back for a further review by different CRA officials (though the Court has the right to order that the CRA reach a particular result).

If you are considering a Federal Court application, note that the timeframe for filing the application is very short — normally 30 days from when the CRA issues its second-level decision (Federal Courts Act, section 18.1).

Remission Orders

By law, neither the CRA nor the Courts can cancel tax that is legally owing. However, there may be unusual circumstances where it is unfair for you to have to pay.

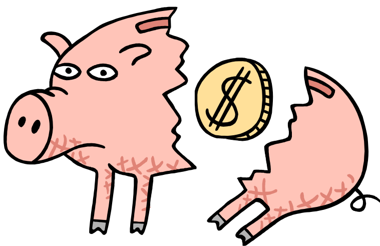
For example, one such situation might be where you relied on CRA misinformation to your detriment, and tax became payable as a result where it would otherwise not have been payable.

In rare cases, it is possible to obtain a **remission order** that cancels tax. A remission order is actually an Order-in-Council passed by the federal Cabinet.

To obtain a remission order, you apply to the Director of your local Tax Services Office. If your request meets the CRA's Remission Guidelines and local officials (at several levels) approve it, it will be forwarded to Ottawa for consideration by a committee; if it still passes, it will go up the chain, eventually reaching the Commissioner of Revenue, then the Minister of National Revenue and finally the Cabinet. The process is a slow one, and usually takes several years. Only a few remission orders are passed each year.

IS YOUR RRSP OR RRIF SAFE?

What happens if you owe money to creditors, including the Canada Revenue Agency? Can your Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF) be seized to pay your debts?



The answer may be yes. Other than on bankruptcy, a regular RRSP or RRIF can be seized by creditors in most provinces, even though the Income Tax Act provides that an RRSP or RRIF cannot be used as security. (However, in Saskatchewan and British Columbia, specific provincial legislation prevents seizure of an RRSP or RRIF, subject to some exceptions.) Note that you can still be liable for tax on the income when your RRSP is cashed in, even though you are not doing so voluntarily.

If the RRSP is set up as **life insurance**, it will likely be exempt from seizure under provincial insurance legislation. However, putting an RRSP into life insurance may not defeat creditors if this is done shortly before going bankrupt.

On bankruptcy, an RRSP or RRIF does not form part of the property that the bankruptcy trustee divides up among the creditors. This is a fairly new rule (paragraph 67(1)(b.3) of the *S* enacted in December 2007). A deferred profit sharing plan is also exempt on bankruptcy, under regulations passed in July 2008. So declaring bankruptcy can actually protect your RRSP or RRIF.

This is a complex and confusing area, and professional legal advice should be sought if you are hoping to keep your RRSP or RRIF safe from your creditors.

AROUND THE COURTS

Sales taxes on legal fees awarded as disbursements

As you may know, Canadian courts generally award "costs" to the winner in most civil litigation. However, "costs" in most cases are only a fraction (perhaps 10-50%) of the winning party's actual legal fees billed to them by their lawyers.

Costs include "disbursements" (e.g., expert reports or travel costs), which, when approved by the Court's registrar or assessment officer, are usually 100% reimbursed by the losing party to the winning party. So having a cost classified as a "disbursement" rather than as "legal fees" is a big plus for the winning side in the litigation.

In a recent GST appeal, *Vachon* (2009 TCC 58), Mr. Vachon was assessed for GST on a transfer of property to him by a corporation which owed GST. He appealed to the Tax Court of Canada, and won. His appeal was allowed "with costs".

In claiming his costs from the government, Vachon claimed **all of the GST and Quebec Sales Tax** that he paid on his lawyer's $10,000 legal bill — about $1,300 in total. For the legal fees themselves, the Tax Court's Tariff restricted the costs to about $1,000. Normally one would have expected only the taxes on $1,000 to be allowed as well.

In a surprising decision, the Tax Court's Assessment Officer allowed the full $1,300 of GST and QST as a disbursement, even though only $1,000 of the $10,000 in legal fees was being allowed. Thus, the entire $1,300 had to be paid by the government to Mr. Vachon. The government did not appeal this decision.

* * *

This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with us before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.

☐ Please contact me to discuss my financial and tax needs.
☐ Please add my name to your tax letter mailing list.

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