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Pay the tax, then fight the battle

WHAT TO DO IF THE TAXMAN HITS YOU WITH A MAJOR REASSESSMENT.

THE ACT DEEMS AN ASSESSMENT TO BE VALID AND BINDING.

So you've just received your notice of assessment in the dreaded brown envelope from the CRA. You open it with trepidation to learn that the CRA has reassessed your taxes from three years ago, and is ordering you to pay an additional \$50,000.



GETTY IMAGES / ISTOCKPHOTO

It's imperative the taxpayer maintain full and detailed records, Vern Krishna advises.

What should you do? First, stop hyperventilating and bring your blood pressure down to a respectable level. Once you catch your breath, immediately remit the taxes demanded to stop the clock on accumulating interest charges. The CRA charges interest on any amounts owing back to the date of the original tax year. The interest is currently calculated at five per cent on a daily compounding basis, and is not deductible for tax purposes. Thus, the five-percent payable is an after-tax cost, which in today's market is an exorbitant cost. By the time you receive the reassessment, there would be nearly three years of accumulated interest charges payable on your account, and you would already owe about \$58,000.

The second step is to immediately file an "objection" with a tax service office (or electronically) that sets out in general terms the reasons, and relevant facts, for your tax-filing position. As a general rule, you have 90 days from the date of sending of the assessment to file your objection. In exceptional circumstances, you can get an extension

from the minister of national revenue if she considers the extension “just and equitable,” but in reality that’s rarely granted. File the objection immediately.

The CRA is required to respond and consider your objection “with all due dispatch.” You will receive a standard response in about eight weeks that acknowledges receipt of your objection, and informs you that you will be contacted by an appeals officer. It may take as long as 10 to 12 months (or longer) for someone to contact you and ask for further details. This is the beginning of a long relationship that you will have with the appeals officer, a CRA employee who will evaluate the agency’s own assessment. During the delay you should cultivate patience, which is why you should pay the tax claimed immediately to avoid accumulating interest charges. Delay works to the government’s advantage through daily compounding of interest.

If you have not heard back from the minister with all due dispatch — a likely scenario — another option is to file an appeal with Tax Court of Canada 90 days after you filed your objection. At this juncture there are new rules and costs to consider.

If the amount in dispute is \$ 25,000 or less, you can elect the “informal procedure,” which is a mildly less intimidating route for selfrepresented individuals who are not trained in the nuances of the judicial system. The advantage of this route is that the entire trial procedure can be completed in less than a year.

If the amount in dispute is more than \$ 25,000, you are stuck with the “general procedures” of the Tax Court, which are steeped in legal formalism and are best left to legal counsel who will represent you. The process is long, adversarial, subject to stringent rules of disclosures, discoveries, and expensive. A complex tax case moving along at a steady clip can last a dozen years, which is another reason to pay the amount of taxes claimed immediately. A debt of \$50,000 accumulating interest at five per cent will grow to about \$ 90,000 in 12 years. The \$ 40,000 in accumulated interest will not be deductible for tax purposes.

There are two other rules that taxpayers should be aware of in tax disputes.

First, the CRA’s assessment is presumed to be correct, unless the taxpayer can demolish the agency’s underlying assumptions of fact. The presumption of validity of an assessment is the single most significant rule for taxpayers. The Act deems an assessment to be valid and binding on the taxpayer, even if it contains an error or defect, or the CRA incorrectly calculates or improperly issues it. This is a formidable presumption — a form of reverse onus burden. Hence, it is imperative that the taxpayer maintain full, complete, and detailed records in support of his or her filing position. The CRA does not need to prove anything after it issues its assessment, which gives the agency a considerable advantage in tax litigation. So remember: the CRA can sit on its hands, and the taxpayer must “demolish” the assessment.

Second, if the taxpayer eventually overcomes the presumption of correctness and wins, he or she will be refunded the full amount paid (\$ 50,000 in the above example) plus interest at three per cent, which will be fully taxable as income. Thus, the government keeps approximately half of what it gives you in interest.

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The notion that the tax system is a purely voluntary structure is deceptively appealing. To be sure, no one is compelled to comply with the Income Tax Act, just as members of the armed forces can ignore the orders of their commanding officer on the battlefield. In tax law, the sanctions are less severe and include protracted civil litigation, forfeiture of property, criminal prosecution, and perhaps even jail.