Tax Court is Not a Court of Equity

By

Vern Krishna, CM, QC, FCPA

Behavioural economists advise that spending money, such as paying taxes, has psychological cost – the pain of paying. What they do not tell us is that not paying our taxes creates even greater pain in the form of penalties and interest. The year is now (June 10) almost half over, and most individuals would have filed their income tax returns and, hopefully, paid any amounts due. The Canada Revenue Agency ("CRA") ensures that it will make it even more painful for taxpayers who do not pay on time. The rules are strict in respect of timing, penalties, and interest (at near criminal rates) that only the government could get away with. There is no equitable relief in taxation.

In simple terms, depending upon the source of one's income, there are two ways of paying income taxes: (1) through withholding at source or (2) in installments. Regardless of the method, taxpayers must pay forthwith the full amount of their assessed taxes, together with any interest and penalties thereon.

Timing

If the taxpayer owes tax at the end of a taxation year after withholdings and installments, the remainder is due on or before his "balance-due" day, which for individuals is usually April 30 of the following year. The balance-due day for an individual who carries on business in a year is June 15 of the following year.

A corporation's balance-due day is usually two months after the end of its taxation year or three months for a Canadian-controlled private corporation.

A taxpayer who is assessed for taxes must pay the amount assessed "forthwith". This is so regardless of whether he objects to the assessment. However, except for large corporations and taxpayers claiming donation shelters, (both of which must immediately pay half of the assessed amount), a Notice of Objection with the CRA effectively stops collection procedures of the assessed tax during the 90-day objection period or while the matter is under appeal to the Tax Court. *However, the Notice does not stop accumulating interest during the objection.*

Indeed, the Minister can demand payment of taxes even *before they are due* if she suspects that the taxpayer is about to leave Canada.

Penalties & Interest

An employer who fails to withhold taxes is liable for penalties under and interest. An employer who fails to *remit* withheld amounts become liable for the amount and, in the case of corporations, renders the directors personally liable. This is when the rules get really painful.

Interest on unpaid taxes accrues on a daily compounded basis at 5% (2021). The accrued interest is *not deductible* for tax purposes, which can raise its effective rate to 10%. It is difficult to invest at such a rate in the market!

The Minister may accept security for payment of taxes or any other amount payable under the Act. *However, the security does not stop accumulating interest during the objection.* Interest payable to the CRA is compounded daily at 5% (June 2021) and is not deductible for tax purposes. Interest received on refunds is calculated at 3% and is taxable. Hence, for a 50% taxpayer the cost is 10% and the refund is worth 1.5%. Not exactly a bargain.

Example

An unpaid federal assessment of $100,000 will accumulate in 5 years to $128,000 with non-deductible interest of approximately $28,000. If the taxpayer objects and successfully challenges the assessment, she will receive a federal refund of interest at 2% below the rate charged (3% in Q2, 2021) at the end of 5 years, that is, $16,000, which will be taxable. For a 50% marginal rate taxpayer must earn $56,000 to pay the interest and will receive $8,000 net of taxes on the refund.

To add insult to injury, there is a 30-day "processing period" during which the government does not pay any in respect of overpayments of tax by an individual.

Withholding Taxes

Withholding taxes (also known as pay-as-you-earn "PAYE") are essentially a form of advance payment of taxes for certain types of income. There are different forms and rates of withholding depending upon the source of income, status of the payee, and tax treaty provisions. For residents of Canada, the amount withheld is an advance payment towards the taxpayer's ultimate liability, which the CRA will finalize upon filing of the tax return. For non-residents, the withholding tax is final, and the non-resident is not required to file a Canadian tax return.

Types of Withholdings

There are two types of withholding taxes: domestic and non-resident. The rates and rules vary for each group.

Domestic Withholding

Every person who pays salary or wages (or various related payments) is required to withhold tax and remit it to the Receiver General on account of the payee's tax for the year. The amount withheld is essentially an advance tax instalment. The payor must remit the tax to the government, which holds it to the credit of the payee. The amount is credited to the taxpayer's account and awaits his final return for the year. Any surplus or deficiency of tax is adjusted at that time.

If properly calculated, the tax withheld from employees should make filing of their returns redundant. In practice, however, many employees have other financial considerations in calculating their final income and the amount withheld is merely one of the elements in determining ultimate liability. Hence, the tax is an advance payment that is subject to final adjustments upon tax filing.

However, an individual's tax liability is not reduced because his employer fails to make the appropriate withholding deduction. The taxpayer who earns the income is always liable to pay tax on that income. The Tax Court will not correct employer or, even, CRA errors or grant relief on grounds of equity or fairness. The Tax Court is not a court of equity.

Non-resident Withholding

The Act requires every person paying fees, commissions or other amounts for services in Canada to a non-resident to withhold and remit 15% tax from the payments.

The tax applies even if the non-resident is exempt from tax and has no tax liability because of a treaty with Canada. The CRA can waive the tax upon application. To obtain a refund, the payee must file a return and claim the treaty exemption.

Actors

Special rules apply to non-resident actors for acting services, who must pay tax of 23 per cent. This tax is a final tax and not merely a payment on account. However, the actor (or corporation) can elect to file a return on "taxable income earned in Canada", in which case the amount withheld is considered a payment on account of Part I tax liability.

The tax is a national cultural incentive tax to employ "Canadian" actors. However, the tax does not apply to income that a non-resident provides for other services in Canada, such as, for example, services as a producer or director. It also does not apply to other non-residents who perform services in the movie industry, for example, to directors, producers or screenwriters or other sectors of the entertainment industry, including musicians or international speakers. These non-residents who perform services in Canada are subject to only the 15 per cent withholding tax.

Do not seek equity in taxation. You will be disappointed. Chin up and just pay the tax.

Professor Vern Krishna, CM, QC, FRSC

Of Counsel, TaxChambers LLP (Toronto)

vern.krishna@taxchambers.ca

www.vernkrishna.com