Filing on the basis of proposed tax legislation

Kim G C Moody FCPA, FCA, TEP
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This is not a new topic. However, it is one that we deal with time and time again… especially in recent years.

Tax policy and the implementation of tax legislation in Canada is under the purview of The Department of Finance. Much of Canada's new tax legislation arises from the annual Federal Budget. However, there are also technical amendments released in draft form (often for public comment) throughout the year. Such draft or proposed legislation may be further amended to correct for errors, provide clarification and address public submissions before it is finally released into a Bill. The Bill is then put before Canada's House of Commons and the Senate for debate and eventually receives Royal Assent and becomes law (unless for some reason the Bill fails to pass). The proposed legislation will often contain detailed "coming into force" provisions that establish the date from which a specific proposed provision will have legal application. Often, but not always, the application of the proposed legislation will be effective from a date earlier (i.e. retroactive effect) than the date that the provision is actually passed into law. The process to convert draft legislation to law can often take a long time.

The Department of Finance may also release "comfort letters" in response to parties' concerns with the technical accuracy of certain existing provisions of the *Income Tax Act* (the "Act"). Such comfort letters often state that The Department of Finance is prepared to correct the perceived problem and further undertake to recommend to the Minister of Finance to release proposals that will achieve such objective. However, the comfort letters are appropriately hedged and state that there is no guarantee that such proposed amendments will become law.

In recent years, there has been a tremendous amount of draft legislation and comfort letters that have been released and have not yet been proclaimed as law. The Office of the Auditor General of Canada pointed out this problem in its 2009 Fall Report.

Two obvious examples of proposed legislation not yet being passed into law come to mind. The first is the non-resident trust and foreign investment entity proposals. These proposals were first introduced in the 1999 Federal Budget and the resulting draft legislation has been revised at least six times over the last 13 years and still remains "proposed" (i.e. not law). The most recent revision resulted in the virtual scrapping of the foreign investment entity proposals but retained the non-resident trust proposals. If passed, much of the effect of these proposals will have retroactive effect to 2007 (with the date of the proposed application being changed many times over the years). The second are the restrictive covenant proposals that were first announced by the Department of Finance on October 7, 2003. Such proposals are extremely complex and we have written extensively on this subject. The restrictive covenant proposals have been amended many times with the most recent being July 2010. Such proposals also have not been passed into law but if passed will generally have retroactive effect to October 7, 2003 (with some exceptions to this general date).

Canada's tax system provides, under section 152, that an individual's tax return for a particular taxation

year is generally “statute-barred” from a reassessment on the 3rd anniversary date of the date that the particular taxation year was assessed. For example, if Mr. Apple’s 2006 personal tax return was filed in April 2007 and was assessed by the Canada Revenue Agency (“CRA”) say May 15, 2007, then Mr. Apple’s 2006 tax return would be prevented from any amendment (either by the CRA or by Mr. Apple) on May 15, 2010.

There are some exceptions to the general rule. For example, if Mr. Apple or the person filing the return made any misrepresentation on the 2006 tax return that was attributable to neglect, carelessness, willful default or committed a fraud then the CRA may reassess beyond the May 15, 2010 date (see subsection 152(4) of the Act). Also, there are some circumstances where Mr. Apple may want to file a waiver, also provided for under subsection 152(4), to the CRA that keeps all or parts of the 2006 return open for reassessment. Mr. Apple may also be able to rely on the “taxpayer relief provisions” of subsection 152(4.2) to extend the statute-barred date if he makes an application no later than the day that is 10 calendar years after the end of the particular taxation year in question if he was entitled to a refund or a reduction of taxes payable for that particular year. Corporations or *inter vivos* trusts are not entitled to benefit from the “taxpayer relief provisions” unlike Mr. Apple as earlier described. Corporations, other than Canadian-controlled private corporations, have similar rules regarding statute-barred dates but generally the date is four years from the date of notice of assessment.

Accordingly, what is a taxpayer to do when they are dealing with a tax matter that might be the subject of proposed legislation? For example, if a taxpayer granted a restrictive covenant in 2011, should he file his tax return on the basis of existing law or under the basis of the proposed legislation (which will generally be very complicated to deal with and may not have favorable tax results in comparison to existing law)? Good question and quite a quandary. When analyzing the issue, one should consider statute barred issues as discussed above and also whether the proposed legislation contains specific provisions that might override the normal rules of subsection 152(4) if a person wanted to ignore the proposed legislation and file on the basis of existing law.

The CRA has a long standing policy that encourages taxpayers to file their tax returns on the basis of proposed legislation. In CRA Income Tax Technical News No. 44, the CRA had the following to say on the topic:

> *“It is the CRA’s longstanding practice to ask taxpayers to file on the basis of proposed legislation. This practice eases both the compliance burden on taxpayers and the administrative burden on the CRA. However, where proposed legislation results in an increase in benefits (for example, Canada child tax benefit) to the taxpayer, or if a significant rebate or refund is at stake, the CRA ’s past practice has generally been to wait until the measure has been enacted.*
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> *A comfort letter is not considered proposed legislation and usually only reflects the Department of Finance’s views on a particular issue affecting a specific taxpayer. Given that our tax system is on the basis of self-assessment, taxpayers may decide to file on the basis of a comfort letter. Generally, the CRA will not reassess taxpayers who filed on the basis of a comfort letter, provided that they did so in conformity with the comfort letter.*
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> *Generally speaking, the CRA will not reassess if the initial assessment was correct in law. As a result, a taxpayer’s request to amend their tax records to reflect proposed legislation will be denied. It is recommended that taxpayers file a waiver in respect of the normal reassessment period to protect their interests.*
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> *In the event that the government announces that it will not proceed with a particular amendment,*

any taxpayers who have filed on the basis of the proposed amendment are expected to take immediate steps to put their affairs in order and, if applicable, pay any taxes owing. Where taxpayers acted reasonably in the circumstances, took immediate steps to put their affairs in order, and paid any taxes owing, the CRA will waive penalties and/or interest as appropriate."

In my opinion, the CRA's guidance usually, but not always, makes sense. From a practical perspective it is also sound. However, everyone's facts are different and, of course, one would need to carefully consider what is appropriate in their circumstances. People should heed professional tax advice on this difficult area of tax law.