

Canadian Court Sides With Taxpayer on Foreign Asset Reporting

Posted on Jul. 5, 2019

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The Tax Court of Canada threw the book at the Canada Revenue Agency after it penalized a largely compliant taxpayer for the late filing of a foreign property disclosure form with misleading instructions.

Canadians with specified foreign property — including shares of capital stock of nonresident corporations — that has a cost of over C \$100,000 during the year are required to report the property on a separate form to aid compliance with foreign-source income reporting and detection of tax evasion and avoidance, according to the CRA.

Scott Moore, who worked for GE Capital Canada between 2010 and 2016 and owned shares of the company's U.S. parent, failed to file a Form T1135, "Foreign Income Verification Statement," for the shares in 2015 — the first year that the cost of the shares topped C \$100,000, according to a [June 26 Tax Court judgment](#). Moore realized his mistake in 2016 when Wells Fargo Canada acquired GE Capital Canada and Moore opted to move his shares to a brokerage account.

Moore alerted the CRA just after the 2016 return deadline and filed T1135 forms for 2015 and 2016. The judgment notes that Moore has since regularly filed T1135 forms and that he reported income from the shares and "was not cavalier about his income tax obligations."

The CRA's 2015 tax return directed taxpayers owning specified foreign property with a cost in excess of C \$100,000 to refer to an Income Tax Guide for 2015 for more information, the judgment says. But the guide's table of contents didn't have a heading for specified foreign property, which is addressed under foreign income, the court noted. A subheading titled "Shares of a Non-Resident Corporation" "literally says nothing about a T1135 form," the court noted.

Judge Patrick Boyle said he doubted that most reasonable Canadians could find the relevant information on foreign property under the foreign income heading and that the section on specified foreign property was "clearly misplaced." He noted that Judge Réal Favreau found in a 2010 T1135 late-filing case that "Canadians could not be expected to know that T1135 late filing penalties would only be waived by CRA if they formally applied under its Voluntary Disclosure Program." Moore didn't know that he would have had to disclose his delinquent filing under the voluntary program to avoid court, the judgment says.

While Judge Judith Woods cautioned in a 2012 T1135 penalty case that "the judge-made due diligence defense should be applied sparingly," Boyle found it appropriate in Moore's case. He also noted that "foreign investments" would be a better heading for the section in the guide on foreign income and specified property, and suggested that Moore's voluntary disclosure is the

type of compliance the CRA should be encouraging.

“I cannot imagine why, in such a case as this, the CRA would prefer to have Mr. Moore appeal to this Court, lose, and then go back to CRA’s Fairness Review program armed with my comments,” Boyle said.

Form T1135 and its corporate equivalent, Form T1134, “are similar to the [foreign bank account report] and Form 8938 [Statement of Foreign Financial Assets], but the rules as to what needs to be reported are complex and sometimes very unclear,” according to Roy Berg, an international tax lawyer based in Calgary. The standard failure-to-file penalties top out at C \$2,500, but if the return isn’t filed after the taxpayer receives a notice from the CRA, the penalties can increase up to C \$24,000, Berg said. If the failure or omission is attributable to gross negligence, the penalty is the greater of C \$24,000 and 5 percent of the cost of the property, he added.

“The court’s opinion is encouraging in that it acknowledges that the CRA’s guidance on filing the T1135 is nearly unnavigable,” but few taxpayers or tax professionals will be comforted by that if they are facing significant noncompliance penalties, Berg said.

“Unfortunately, the CRA has taken a very rigid approach to these types of cases and routinely will apply the late-filing penalties regardless of the circumstances,” said Kim Moody of Moodys Gartner Tax Law LLP. The agency also wants voluntary disclosures to follow a rigid protocol implemented roughly 18 months ago, he said. Many tax professionals have argued that the new program will discourage taxpayers from coming forward to correct simple deficiencies, and some of Boyle’s comments “echo those concerns from many in the tax community,” Moody said.