tax notes international
Volume 55, Number 2 ■ July 13, 2009

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Reprinted from *Tax Notes Int'l*, July 13, 2009, p. 141

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PRACTITIONERS' CORNER

Canadian Late Filing Penalty Successfully Challenged

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Taxpayers that fail to file Canadian income tax returns on a timely basis may be subject to late filing penalties under the Canadian Income Tax Act (the Act). For instance, subsection 162(1) of the Act provides that Canadian resident taxpayers that file their income tax returns late are generally subject to a penalty equal to a stipulated percentage of their tax payable for the relevant tax year. When a Canadian resident taxpayer is not liable for Canadian tax in respect of a particular tax year, no late filing penalties generally arise.

In an effort to ensure that all nonresident corporations that may be subject to tax in Canada file Canadian income tax returns on a timely basis, the Canadian government introduced a special penalty provision that is solely applicable to nonresident corporations. Subsection 162(2.1) of the Act provides that nonresident corporations that are ''liable to a penalty'' under subsection 162(1) of the Act in respect of the late filing of a tax return are subject to a penalty *equal to the greater of*:

- the amount of the penalty otherwise payable under subsection 162(1); and
- an amount equal to the greater of C $100 or C $25 times the number of days, not exceeding 100, from the day on which the relevant return was required to be filed to the day on which the return was filed.

Subsection 162(2.1) is ostensibly aimed at subjecting nonresident corporations that file their Canadian income tax returns late to a penalty at least equal to the penalty that is imposed under the Act in respect of the late filing of other ''information returns.'' (The penalty imposed under subsection 162(7) of the Act in respect of the late filing of most ''information returns'' is generally computed on the basis of the number of days by which the required ''information return'' is late, up to a maximum penalty of C $2,500).[1]

The Canada Revenue Agency has historically asserted that a nonresident corporation may be ''liable to a penalty'' under subsection 162(1) of the Act even in cases when no Canadian tax is payable by the corporation in respect of the relevant tax year.[2] However, in a case recently heard by the Tax Court of Canada, the court held that a nonresident corporation could not be said to be ''liable to a penalty'' under subsection 162(1) of the Act when no Canadian income tax was payable by the corporation. As a result, no penalty could be said to arise under subsection 162(2.1) of the Act under such circumstances.

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[1]The Technical Notes released by the Department of Finance (Canada) in connection with the introduction of subsection 162(2.1) indicated that the new provision was meant to operate to:

> subject non-resident corporations to the effect of the ''regular'' penalties under subsections 162(1) and (2) in respect of a failure to file an income tax return and, consistent with the role of that tax return as an information return for those corporations that claim an exception from Canadian tax as a result of the application of a tax treaty, to the alternative penalties that would apply under subsection 162(7) of the [Tax] Act if a separate information return had been required in respect of those corporations.

[2]*See, e.g.*, CRA, Technical Interpretation Letter No. 2006-0195531E5 (Oct. 3, 2006).

Facts

In *Goar, Allison & Associates Inc. v. The Queen*,[3] the taxpayer was a nonresident corporation that was engaged in providing ''engineering technology'' to clientele in both the United States and abroad. The corporation had historically filed any required Canadian tax returns on a timely basis. Yet, at some time before the middle of 2006, the officer of the corporation that had previously attended to the filing of the corporation's Canadian tax returns died unexpectedly. As a consequence, the filing of a Canadian income tax return in respect of the corporation's 2005 tax year was inadvertently overlooked. Ultimately, in response to a written request received from the CRA, the corporation filed its 2005 Canadian tax return, approximately six months after the statutory deadline for filing the return.

The Minister of National Revenue (MNR) assessed the corporation's 2005 Canadian tax return on the basis that, while no Canadian Part I tax was payable, a late filing penalty of C $2,500 was applicable under subsection 162(2.1) of the Act.

Tax Court Judgment

The key issue in *Goar* concerned whether a late-filing penalty may be imposed under subsection 162(2.1) of the Act when the nonresident taxpayer had no Canadian taxes payable for the relevant year.

The MNR asserted that as long as a required Canadian income tax return was not filed on a timely basis, the nonresident corporation may rightly be said to have been ''liable to a penalty'' under subsection 162(1) of the Act, even if the penalty equated to $0 because the corporation had no Canadian tax payable in respect of its 2005 tax year. As a consequence, the MNR concluded that the taxpayer was liable for a 162(2.1) penalty.

However, despite the MNR's assertions, Justice Miller, speaking on behalf of the Tax Court of Canada, held that a nonresident corporation will not be liable for a penalty under subsection 162(2.1) of the Act when it has no Canadian tax owing because the application of a 162(2.1) penalty depends on the corporation being ''liable to a penalty'' under subsection 162(1) or (2) of the Act, which, in turn, requires the corporation to have tax payable under Part I of the Act. Justice Miller rejected the MNR's argument that a taxpayer may be subject to a penalty under subsection 162(2.1) of the Act when no monetary penalty was payable under subsection 162(1) of the Act.

In rendering his judgment, Justice Miller considered the MNR's argument that some extrinsic aids, including the Technical Notes that accompanied the introduction of subsection 162(2.1) of the Act, indicated that the provision was meant to impose a penalty on all nonresident corporations that file an income tax return late, regardless of whether any Canadian tax was owing for the relevant tax year. Justice Miller dismissed that argument on the basis of the wording of subsection 162(2.1) and noted:

> While this may have been the legislator's intention, I am not swayed frankly that they got it right. I find the words are clear as they are written and . . . technical notes cannot override that clear meaning.[4]

Justice Miller also commented on the manner in which penalty provisions in the Act should be interpreted, stating:

> Where the Government penalizes a taxpayer, and in this case a non-resident, I am of the view that such penalty provision should be absolutely crystal clear. If there is ambiguity, it should be resolved in favour of the taxpayer. However, in this particular provision, I find no ambiguity. If the non-resident does not owe tax, the non-resident is not subject to the subsection 162(2.1) penalty.[5]

On the basis of the foregoing, the Tax Court allowed the taxpayer's appeal and referred the case back to the MNR for reassessment on the basis that no subsection 162(2.1) penalty was applicable.

Implications of *Goar*

The MNR has chosen not to appeal the decision rendered by the Tax Court in *Goar*. Nevertheless, in considering the implications of the *Goar* decision, it is important to note that the Court's judgment was rendered under the Tax Court's ''informal procedure.'' Under section 18.28 of the Tax Court of Canada Act, decisions rendered under the informal procedure do not constitute binding precedents. Therefore, the Tax Court technically is not obligated in the future to adhere to the principles articulated by Justice Miller in *Goar*. However, the Tax Court generally regards decisions rendered under the Court's informal procedure to be of persuasive authority.

To date, the CRA has yet to indicate whether it will adjust its assessing practices to accord with the judgment rendered by the Tax Court in *Goar*.

Nonresident taxpayers that have recently been assessed for penalties under subsection 162(2.1) of the Act may wish to consider whether it would be prudent

[3]2009 D.T.C. 1125 (T.C.C.) (Informal Procedure) (''*Goar*''). The case was heard on January 15, 2009, and the decision was initially rendered orally on the day of the hearing. The written version of the judgment was released on April 3, 2009.

[4]*Id.* at para. 11.

[5]*Id.* at para. 12.

to file a notice of objection in response to any such assessment. Under subsection 165(1) of the Act, a notice of objection in respect of an assessment of a corporation may be filed on or before the day that is 90 days after the date of mailing of the relevant notice of assessment.[6]

The judgment rendered by the Tax Court in *Goar* addresses several interesting principles of statutory interpretation and reaffirms the court's past inclination to resolve matters of ambiguity in favor of the taxpayer. Nonresident corporations that are required to file Canadian income tax returns for a particular tax year would be well advised to closely monitor the CRA's response to the judgment rendered in *Goar* in order to properly assess the implications of filing a tax return late, including the available means of addressing the potential imposition of late filing penalties. ◆

[6]Under some circumstances, a taxpayer may be entitled to request that the MNR grant a one-year extension to prepare and file a contemplated notice of objection.