



Top 2021 Tax Court Cases for Owner-Managed Businesses

January 2022 Tax Alert

Despite the CRA staffing issues and the years-long backlog at the Tax Court of Canada, tax disputes continue to arise and move forward to resolution. As with each year, 2021 again saw several important decisions from the Tax Court of Canada that will impact owner-managed businesses. Below is a review of some of these top decisions.

I. Employing Family Members – Salary and Wage Deductions

Many owner-managed businesses employ family members of the owner. Over the last several years, the CRA has focused on auditing the validity of wages or salary paid to these family members.

In the matter of *Prunoiu v. Agence du revenue du Quebec*, the owner of a small trucking company was personally assessed an income inclusion in regards to amounts paid to his family members, along with gross negligence penalties. At the trial, the owner was unable to clearly establish that his spouse and in-laws had worked for the company and were properly paid by the company. As a result, in scathing language, the Court upheld the assessments and held that it was clear that the owner was playing a game of creating accounting entries for the sole purpose of reducing income and paying less tax.

In review, especially for owner-managed businesses, the work performed by family members, the employee income paid, and

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the calculations of the employee income, must be properly documented. The burden is borne by the taxpayer to establish that their family members were proper employees and the expenses in regards to the same were valid.

II. Employing Family Members – EI Eligibility

If a family member is employed, their earnings are likely excluded from being considered insurable earnings for EI purposes. , had they been dealing with each other at arm's length. This is an often-litigated exception, where a non-arm's length employee seeks EI entitlement. An exception to this general rule is where the Minister of National Revenue is satisfied that the employment relationship is substantially similar to what the relationship would have been, had they been dealing with each other at arm's length. This is an often-litigated exception, where a non-arm's length employee seeks EI entitlement.

In the matter of *Dolynchuk v. MNR*, the employee was the common law spouse of the owner and owned a portion of the shares. Unlike all of the other employees at the company, Ms. Dolynchuk did not complete timesheets, received wages of no fixed amount, and was paid as and when the company decided to pay her. Given these facts, the Tax Court held that she was not treated as an arm's length employee and thus was not earning insurable earnings for EI purposes.

Given the above, for owner-managed businesses, if you wish for employed family members to be eligible for EI, you must be careful to treat them the same as all other employees of the business.

III. Director Liability – Potential Never Ending Liability

As was covered in our [September emailer](#), when a corporation is a tax debtor, its directors can be held liable and assessed accordingly. To avoid potential liability, directors can properly resign or dissolve the corporation. Once this occurs, then the CRA has two years to assess the directors under the *Income Tax Act* and the *Excise Tax Act*. However, in order for the two-year limitation period to commence further to a resignation, the

resignation must be a proper resignation – in writing and properly tendered. The director must also ensure that they do not remain as an unofficial or effective director (known as a de facto director).

In the matter of *Tran v. The Queen*, a taxpayer was assessed as a director in regards to over \$300,000 of a corporation's tax liabilities. The taxpayer attempted to challenge this assessment on the basis that he had resigned from his employment more than two years prior to the assessment. The Tax Court dismissed the appeal, holding that the employment resignation did not constitute proper director resignation. In addition to resigning as an employee, the taxpayer also had to resign as a director and notify the government of the same.

Given the above, if an individual is resigning as a director of an actual or potential corporate tax debtor, they must be careful to ensure that they do so properly and keep a record of it. If an individual fails to properly resign as a director, the CRA can assess them at any point in time, even decades after the corporation's tax liability arose.

IV. Director Liability – Due Diligence Defence

If a director is assessed by the CRA in regards to a corporation's tax liability, the taxpayer may challenge the assessment based on the grounds of due diligence. In order to successfully advance the defence of due diligence, the director must establish that they did everything they reasonably could to ensure the corporation satisfied its tax obligations.

In order to exercise due diligence, the Court has made it clear that a director cannot rest entirely on the company's accountants. Instead, must exercise some oversight, to ensure compliance. In the matter of *Newhook v. The Queen*, the Court held the director failed to exercise due diligence in regards to the company's GST/HST remittances. The taxpayer was the sole director and shareholder of a construction company, with no experience in accounting. The director argued that by relying on an accountant to undertake the necessary compliance, he had exercised due diligence. The Court disagreed and said a director cannot

abandon all responsibility by relying entirely on an accountant.

Given the above, while accountants play an important role in ensuring tax compliance, directors must still take the time to review their obligations with their accountants and ensure that they are being met.

V. Appeal Process - CEWS Disputes

Further to the ongoing pandemic, in order to support impacted employers, the Canada Emergency Wage Subsidy ("CEWS") was established. Under the CEWS program, if an employer has experienced a sufficient negative impact to their revenue as a result of the pandemic, they may qualify for the CEWS. In order to obtain the CEWS, employers are to submit an application, for each relevant period, to the Minister of National Revenue.

As this is a new and evolving program, we are just starting to see some Court decisions regarding the CEWS. In *Canada (Attorney General) v. Iris Technologies Inc.*, a taxpayer brought an application for judicial review of the Minister's rejection of its CEWS application. The application sought that the Court order CEWS payments and for notices of assessment to be issued accordingly. The Minister challenged that the application was not brought in the right Court, contending it should be heard before the Tax Court. The Federal Court denied the Minister's motion and the Minister appealed. On appeal, the Federal Court of Appeal, held that, as the taxpayer was clearly seeking to challenge the correctness of a refund calculation and to appeal a determination, relief rests solely with the Tax Court of Canada.

Given this decision, taxpayers should be careful in determining how to properly challenge Ministerial determinations in regards to their CEWS applications.

VI. Appeal Process - Deadlines to Dispute

As taxpayers are all too often reminded, if you miss a deadline to object or appeal an assessment, at some point, there will be no further recourse available. For example, in the matter of *Nijabat Contracting Inc. v. Canada*, a taxpayer was assessed penalties in

regards to an alleged fraudulent Record of Employment issued to an employee. The taxpayer's position was that the employee had worked for the company and was paid for her work in cash. The taxpayer was unable to appeal the decision because it filed an application for leave to appeal after the statutory deadline. This decision stresses yet again the importance of ensuring that objection or appeal deadlines are not missed.

In review of the above cases, owner-managed businesses must ensure they handle matters strategically, so that they come from a well-prepared place, in the event of a tax dispute. For more information or to discuss with one of our tax litigators, please contact [our firm](#).

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