



Tax Court of Canada Confirms: Business Owners Beware Receiving Dividends from your Struggling Business

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When a business is indebted to the Canada Revenue Agency, they have a variety of ways to collect. One option is for the CRA to assess anyone who received money from the tax debtor business without proper consideration. This applies both if the business was a tax debtor when the money was paid out and if the business is later retroactively deemed to be a tax debtor when the money was paid out. For example, a business owner who gave themselves a generous bonus in 2020 may see that bonus clawed away by the CRA, if the business is assessed in 2022 as owing taxes and interest in regards to the 2019 tax year. The potential tax liability is even more likely when the money received from the business was a dividend.

Recently, in the matter of *Murphy v. The King*, a taxpayer was assessed in regards to the tax liability of his business. The business owed the CRA over \$109,000. While the business was indebted, the taxpayer had his business pay him a dividend of \$140,500. The CRA assessed the taxpayer as being personally liable for the business' tax debt under section 160 of the *Income Tax Act* (the "Act"). Under this section, a person may be assessed in regards to the tax debt of another, if: 1) the person received property (e.g. income, dividends, etc.) from a tax debtor; 2) the person was not dealing at arms length with the tax debtor; and 3)

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the person gave less than fair market value for the transferred property. In the matter of *Murphy*, the taxpayer claimed that the dividend was paid for his services to the business as a licensed insolvency trustee. As such, the taxpayer claimed there was fair market value consideration provided in regards to the dividend. The Tax Court of Canada dismissed the taxpayer's case. In particular, the Tax Court of Canada confirmed the caselaw that dividends are provided to shareholders, further to them being shareholders. As such, dividends can never be provided further to services and can never be received with fair market value consideration. As a result, the Tax Court of Canada confirmed that the taxpayer was jointly and severally liable for the tax debt, based on the amount of the dividend he received.

In review of the above, it is important for business owners to be mindful when they are receiving money from a business that is a tax debtor or may be later retroactively be assessed as a tax debtor. If a business owner is taking money further to providing services to the business, that money should not be paid as a dividend. Any money paid as a dividend will be automatically deemed as being received without fair market value consideration.

If you are concerned about your potential tax liability as a result of your business' tax obligations, please speak with [one of our tax litigators](#).

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