

Can't set back taxation clock



**AIRD & BERLIS
TAXLINE**

**By
Milovan
Prelevic**

The Tax Court of Canada recently delivered a judgment that illustrates the consequences of correcting your mistakes the illegal way: by forging backdated documents. *Gestion Forêt-Dale Inc. c. R.*, is the story of a botched corporate reorganization and a failed cover-up scheme.

The initial planning took place in the spring of 1995. The corporations involved all had a June 30 fiscal year-end, so it was decided to make the reorganization effective July 1. However, the closing documents could not be completed without financial statements for the fiscal year ending June 30, 1995. When the financial statements became available on Sept. 19, 1995, the accountants and notary quickly finalized the closing documents. The closing took place on Sept. 26, 1995. All of the documents were dated July 1, 1995.

One part of the re-organization

involved a numbered company redeeming its Class E non-voting shares, which were held by the appellant corporation. Subsection 84(3) of the Income Tax Act triggered a deemed dividend to the extent that the redemption price exceeded the paid-up capital of the shares. Of course, paragraph 186(1)(a) would subject the deemed dividend to Part IV tax unless the corporations were connected.

Herein lay the accountants' and notary's mistake: the corporations were not connected within the meaning of subsection 186(4) because the appellant did not hold any voting shares in the payer corporation.

In or around November 1996, the accountants realized their mistake. They decided to correct it by preparing two new corporate resolutions, both dated July 1, 1995. The first purported to issue Class B voting shares to the appellant at 7:45 a.m. The second purported to redeem the Class B shares at 5:45 p.m. (despite the fact that the shares were not redeemable under the company's articles). Though the resolutions were signed, neither the subscription price nor the redemption price was ever paid.

The accountants also prepared and filed the appellant's income tax return for its taxation year ending June 30, 1996. The return — signed on Nov. 13, 1996 — was prepared on the basis that no Part IV tax was

payable because the corporations were connected on July 1, 1995.

Nearly two years later (in or around July 1998), the accountants noticed a mistake they had made during their hasty cover-up back in 1996. If the corporations had become connected at 7:45 a.m. on July 1, 1995, section 84.1 would have applied to a subsequent step in the re-organization. The accountants purported to remedy this problem by drafting a new resolution issuing the Class B voting shares at 4:45 p.m. instead of the original 7:45 a.m.

In November 1998, the Canada Revenue Agency (CRA) began auditing the 1995 re-organization. During the course of the audit, the accountants and notary repeatedly asserted — both orally and in writing — that all of the resolutions were signed at or shortly after the Sept. 26 1995 closing. This ultimately proved inconsistent with other evidence showing that the disputed resolutions had only been signed in 1996 and 1998, not in 1995 as had been claimed. Moreover, forensic analysis established that the 1998 resolution could not have been prepared and signed before January 1997, when the paper on which it was printed first came into use.

The CRA issued a notice of reassessment on May 27, 2002, claiming \$113,289 in Part IV tax, a \$56,644 penalty and \$91,724.39 in interest. The court considered two

main issues: the validity of the Part IV reassessment, and the imposition of the penalty.

The assessment had been made beyond the normal three-year reassessment period. To be valid, such a reassessment would have to satisfy the conditions of subparagraph 152(4)(a)(i):

152. (4) Assessment and reassessment (limitation period) — The minister may at any time make an assessment of tax for a taxation year, interest or penalties, if any, payable under this part by a taxpayer... except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if:

(a) The taxpayer or person filing the return

(i) has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filing the return or in supplying any information under this act.

The court was satisfied that the tax return filed in November 1996 misrepresented the fact that the corporations had not been connected on July 1, 1995. Moreover, the record showed that the misrepresentation was made with full knowledge, and was coupled with an obvious attempt to conceal the truth and engage in retroactive tax planning.

Since subsection 187(3) makes section 152 applicable to Part IV,

the normal three-year limitation period did not apply, and the reassessment was therefore valid. The evidence clearly established that the corporations had not been connected when the Class E non-voting shares were redeemed. Thus, Part IV tax was payable.

From this analysis, it naturally also followed that the court would confirm the penalty under subsection 163(2):

163. (2) False statements or omissions — Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a "return") filed or made in respect of a taxation year for the purposes of this act, is liable to a penalty of the greater of \$100 and 50 per cent of the total of ...

Let this be a cautionary tale to all of us in the tax-planning business. You cannot magically transform a false return into an honest one by forging backdated documents after the fact. Don't even think about doing it. Tax evasion is always a bad idea.

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Fundraising guidance still has challenges

By TERRANCE CARTER

The Charities Directorate of the Canada Revenue Agency (CRA) released its much anticipated guidance: Fundraising by Registered Charities in June. The guidance replaces CRA's previous policy on fundraising entitled *Applicants that are Established to Hold Periodic Fundraisers*.

The CRA previously released two draft versions of the guidance and additional information in March and June of 2008, collectively called the proposed policy. As such, the guidance has been in refinement for over a year.

Given the importance of fundraising to the charitable sector, its release has been closely followed by most stakeholders. However, while the guidance represents a significant improvement over the proposed policy, it will likely prove challenging for most charities to comply.

Some of the key features of the guidance are:

- Fundraising in the charitable context: If a fundraising activity is appended to another activity that is directed at achieving a charitable purpose, the charity may, under certain situations, allocate the costs between fundraising and

charitable expenditures. However, in addition to having to comply with the terms of the guidance, charities must also meet all other requirements of the *Income Tax Act*, such as its annual disbursement quota. While this fact is not a change in CRA's position, it had not been expressly stated in the proposed policy, which might otherwise have led to confusion between the need to comply with statutory disbursement quota requirements and fundraising expenditure requirements in the proposed policy.

- Definition of fundraising and other terms: As a general rule, fundraising constitutes any activity related to a solicitation of support, either carried out by the charity or by another party acting on the charity's behalf, but does not include requests for funding from governments or other registered charities.

- Prohibited fundraising conduct: Four types of prohibited conduct related to fundraising are outlined, these being fundraising that: (A) is illegal or contrary to public policy; (B) is a main or independent purpose of the charity; (C) results in more than an incidental or proportionate private benefit to individuals or corporations; and



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(D) is misleading or deceptive.

- Allocation of fundraising expenditures: A registered charity must report all fundraising expenditures in its T3010A annual information return (as well as T3010B for year ends after Jan. 1, 2009). However, an activity does not have to be included as a fundraising expenditure if it can be demonstrated that the activity would have been undertaken whether or not it included a solicitation of support. There are two methods by which this can be demonstrated: (1) the 'substantially all test,' such that the charity does not have to report any

of the costs of the activity as fundraising expenditures; or (2) the 'four part test,' which allows the charity to allocate a portion of the costs as non-fundraising expenditures. However, charities will likely find some aspects of the 'four part test' to be unusually complex.

- Evaluation of fundraising activities: The previous rigidity and arbitrariness of using five fixed percentage ranges as an initial determination tool was a major subject of criticism of the proposed policy, whereas the guidance establishes a far more flexible approach. In this regard, the guidance introduces revised fundraising cost to revenue ratios. When under 35 per cent, it is unlikely to generate questions or concerns; when 35 per cent and above, the CRA will examine the average ratio over recent years to determine if there is a trend of high fundraising costs. The higher the ratio, the more likely it is that a more detailed assessment of expenditures will be required; When above 70 per cent, the charity will be required to provide an explanation and rationale for this level of expenditure to show that it is in compliance; otherwise, it will not be acceptable.

In addition, the guidance sets out a number of factors that are to be considered in the evaluation of fundraising activities, as well as a series of 'best practices' and 'areas of concern' that can be considered by the CRA.

While the guidance constitutes a noticeable improvement over the proposed policy, charities and their professional advisors should be aware that many of the concerns about the proposed policy that were raised during the public consultation phase continue to be found within the guidance. Some of those concerns are:

- While the language has been simplified and the length reduced, the substantive concepts from the proposed policy remain largely unchanged, such that the guidance still constitutes a complex document that could prove difficult for charities to fully understand and implement.

- The more flexible and open-ended approach to evaluating fundraising activity is certainly an improvement over the proposed policy. However, many of the factors and criteria in the guidance continue to be open to subjective interpretation. As such, there will

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Social media can have business potential



**COMPUTER
MONITOR**

By
**Richard
Morochove**

Can using social media help in business, or is it just one big time sink? Many businesses have banned the use of certain social media sites, such as Facebook, at work. I know one organization's acceptable Internet use policy considers logging onto Facebook just one notch less unacceptable than visiting a pornography site.

Are all social media sites designed more for personal entertainment than practical business needs?

Tarring all social media with the Facebook brush ignores the fact that there are a wide range of different social media technologies and sites. Some can offer business benefits to accountants and finance professionals.

Industrial media, or traditional media products, are created by professional teams and distributed to the public. Industrial media includes magazines, newspapers, radio and television.

Social media, on the other hand, are created by its users. One may be both a creator and consumer of social media.

Both social and industrial media may reach anywhere from a handful to hundreds of thousands of people. Unlike industrial media, the tools used to create social media are free or low-cost. Furthermore, social media tools are easy to learn and do not require professional training.

There are many types of social media including: communication sites which offer social networking (such as Facebook) and blogging; collaboration sites such as wikis (of which Wikipedia is one example) and many web bulletin boards. Even 'old school' applications such as e-mail can be used as social media by means of a shared distribution list which sends an e-mail message to every subscriber in the group.

While social networking sites such as Facebook and MySpace are targeted for personal users, other social networks such as LinkedIn are aimed primarily at business users.

LinkedIn is based upon the concept of 'six degrees of separation.' This is the theory that if you are one step away from a friend and two steps away from a friend of your friend, then you are at most six steps away from anyone in the world.

LinkedIn lets you set up a listing and access basic functions at no charge (certain enhanced capabilities require subscription payment). The LinkedIn listing looks a little like a resume, with your business background and education experience highlighted. However, one can also list upcoming trips, books you are reading, recommend others in your

LinkedIn network and more.

LinkedIn lets you invite others, such as a business colleague or co-worker, to join your network as a first-degree connection. This can help you keep track of people as they change organizations and responsibilities. LinkedIn also lets you access second and third-degree connections. This can give you a wide range of contacts. I currently have 147 first-degree LinkedIn connections, but this jumps to almost 1.4 million people when considering all network connections to the third degree.

I can't directly attribute any new clients to my LinkedIn presence, although I know others have had success using this service. However, LinkedIn has allowed me to re-connect with a number of former business colleagues and past clients.

Blogs (a contraction of web logs) are one of the most popular ways to communicate on the Internet. They offer a simple front-end to a relatively sophisticated electronic publishing back end, complete with a searchable database.

Wordpress.org is just one example of a blogging application. You can either install the WordPress blogging software on your own website or use it as a hosted application on Wordpress.com.

The blog's ease of use makes it simpler to post a comment using this software, than to fire up a webpage design application. Visitors to your blog can comment on your posts. Other bloggers may also link to your post, if they find it noteworthy.

Yes, there are accounting-

related blogs. Chartered accountant Bill Kennedy writes the Energized Accounting blog at energizedaccounting.blogspot.com. You'll find a number of accounting-related blogs at www.accountingweb.com/blogs.

If a posting to a blog sounds too intimidating, then micro-blogging may be more appealing. Twitter.com is probably the most popular of the micro-blogs. A post on Twitter, also called a tweet, is limited to a scant 140 characters. It's designed to be easy to post tweets from a mobile device, such as a cellphone.

You can search tweets by keyword, such as 'accounting.' However, such a broad term delivers a torrent of results, a dozen or more incoming tweets per minute, ranging from new positions in

finance to students commenting on course work.

I'm not as keen on the business applications of micro-blogs such as Twitter, compared to the standard blogs, such as those offered by WordPress. The short character limit of each post makes it difficult to offer substantive thoughts, unless one makes a series of posts. So a micro-blog with mobile support such as Twitter seems better positioned for describing events as they happen, such as conference proceedings, for example.

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Rolling average better choice

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likely be variations and inconsistencies in the interpretation of the guidance by charities and their professional advisors, as well as by CRA auditors.

• Although the 'best practices' and 'areas of concern' are not requirements that must be followed by charities, some of those recommendations may prove challenging for charities to comply with. Specifically, the guidance emphasizes the importance of public disclosure and transparency regarding the cost of fundraising activities. While there is no disagreement that transparency in and disclosure of fundraising costs is important, the extent of the expectation placed on charities by the guidance may result in some charities having difficulty in attracting donors when it is necessary for the charity to disclose the estimated fundraising costs and revenues of its annual budget.

• Due to the time delays that often occur in fundraising cam-

Specifically, the guidance emphasizes the importance of public disclosure and transparency regarding the cost of fundraising activities.

Terrance Carter, Carters Professional Corporation

paigns from when donations are requested to when they are received, it would have been preferable if CRA had used a rolling average (e.g. over several years) as the basis for evaluation instead of on a single fiscal year basis.

While the guidance is a marked improvement over the proposed policy, it will likely prove to be a challenging document for charities and their professional advisors. As a result, it may take the charitable sector some time to fully comprehend its implications.

Given that the guidance is only intended to constitute a clarification of CRA's position on

fundraising, it will apply to audits in both future and past years. As such, it is important that all registered charities which depend on fundraising, together with their staff, board members and professional advisors, become familiar with the content of the guidance. The ability of a charity to retain its status may very depend on whether it can show it has made reasonable efforts to meet the requirements.

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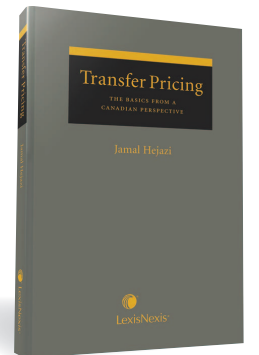
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