THE P FACTOR: THE PUZZLING PREDICAMENT POSED BY PROBLEMATIC PENALTY PROVISIONS— ARE NON-RESIDENT CORPORATIONS THAT LATE-FILE NIL RETURNS SUBJECT TO PENALTIES?

Goar, Allison & Associates Inc. v. The Queen
2009 DTC 653 (TCC)

Exida.com Limited Liability Company et al. v. The Queen
2009 DTC 1278 (TCC)

KEYWORDS: NON-RESIDENT ■ PENALTIES ■ TAX ■ RETURNS ■ CORPORATIONS

Non-resident corporations that carry on business in Canada in a year are generally required to file a Canadian income tax return by virtue of the broad wording of subsection 2(3). A non-resident corporation that fails to file a Canadian income tax return on time may be subject to a penalty under subsection 162(2.1). The application of such a penalty "is relevant to a large number of non-resident corporations that carry on business in Canada,"[23] and yet, until recently, had not been considered by the courts.

The key issue in both *Goar, Allison & Associates Inc.*[24] and *Exida.com* was the same—can a late-filing penalty be imposed under subsection 162(2.1) when a non-resident corporate taxpayer has no Canadian income taxes payable for the relevant year? Although the two cases focused on the same issue and were heard by the same court only months apart, they were decided in different and fundamentally inconsistent ways. In *Goar*, Miller J held that a late-filing penalty was not exigible; in *Exida.com*, Woods J held that a penalty would apply in the relevant circumstances.

Statutory Framework

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

In an effort to ensure that all non-resident 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 non-resident corporations. Subsection 162(2.1) provides that non-resident corporations that are "liable to a penalty" under subsection 162(1) or (2) in respect of the late filing of a

23 *Exida.com Limited Liability Company et al. v. The Queen*, 2009 DTC 1278, at paragraph 8 (TCC). (*Exida.com* was heard together with *Tonoga Inc. v. The Queen*.)

24 *Goar, Allison & Associates Inc. v. The Queen*, 2009 DTC 653 (TCC).

tax return are subject to a penalty equal to the greater of (1) the amount of the penalty otherwise payable under subsection 162(1) or (2) and (2) an amount equal to the greater of $100 and $25 times the number of days, not exceeding 100, from the day on which the return was filed.

Subsection 162(2.1) is arguably aimed at subjecting non-resident corporations that late-file their Canadian income tax returns to a penalty at least equal to the penalty that is imposed in respect of the late filing of "information returns." Under subsection 162(7), a penalty may be imposed in respect of a failure to file most information returns on a timely basis or a failure to comply with a duty or obligation imposed by the Act. A subsection 162(7) penalty is generally computed on the basis of the number of days by which the relevant failure continues, up to a maximum of $2,500. Subject to certain exceptions, subsection 162(7) does not apply where another provision of the Act "sets out a penalty for the failure."

The technical notes released by the Department of Finance 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 Act if a separate information return had been required in respect of those corporations.[25]

The CRA has historically asserted that a penalty under subsection 162(2.1) is applicable to a non-resident corporation even if no Canadian tax is owed by the taxpayer in respect of the relevant year.[26]

FACTS

In *Goar*, the taxpayer was a non-resident corporation that provided certain engineering technology to clientele in the United States and abroad. The corporation had historically filed all required Canadian tax returns on a timely basis. At some time prior to the middle of 2006, the officer of the corporation who had previously attended to the filing of the corporation's Canadian tax returns passed away unexpectedly. As a consequence, the filing of a Canadian income tax return in respect of the corporation's 2005 taxation year was inadvertently overlooked. Ultimately, in response to a written request from the CRA, the corporation filed its 2005 Canadian tax return approximately six months after the statutory filing deadline. The minister assessed the corporation's 2005 Canadian tax return on the basis that while no tax

25 Canada, Department of Finance, *Legislative Proposals and Explanatory Notes Relating to Income Tax* (Ottawa: Department of Finance, October 1998), clause 65.

26 See, for example, CRA document no. 2006-0195531E5, October 3, 2006.

was payable under part I of the Act, a late-filing penalty of $2,500 was applicable pursuant to subsection 162(2.1).

In *Exida.com*, the Tax Court heard the appeals of two non-resident taxpayers, Exida.com LLC and Tonoga Inc., from assessments of penalties under subsection 162(2.1) in respect of taxation years for which neither taxpayer had tax payable. The taxpayers were US-resident corporations that carried on business in Canada. Exida.com provided training products and services to automation hardware manufacturers and process-market end users. Exida.com carried on business in Canada during the 2003-5 taxation years and did not file Canadian income tax returns in a timely manner in respect of each of the three years. Similarly, Tonoga Inc., which was a developer and manufacturer of advanced engineered composite materials, carried on business in Canada during the 2004 taxation year and late-filed its Canadian income tax return.

As in *Goar*, the minister assessed both non-resident corporations for the taxation years in which they carried on business in Canada on the basis that a late-filing penalty of $2,500 was payable under subsection 162(2.1), despite the fact that neither corporation had Canadian part I tax payable for the relevant years.

THE TAX COURT JUDGMENTS

In *Goar*, the minister asserted that so long as a required Canadian income tax return was not filed on a timely basis, the non-resident corporation may rightly be said to have been "liable to a penalty" under subsection 162(1), even if the penalty equated to $0 because the corporation had no Canadian tax payable in respect of its 2005 taxation year; therefore, the taxpayer was liable for a subsection 162(2.1) penalty.

Miller J, on behalf of the Tax Court, held that a non-resident corporation will not be liable for a penalty under subsection 162(2.1) when it has no Canadian tax owing because the application of a subsection 162(2.1) penalty depends upon the corporation being "liable to a penalty" under subsection 162(1) or (2), which in turn requires the corporation to have tax payable under part I of the Act. Miller J rejected the minister's argument that a taxpayer may be subject to a penalty under subsection 162(2.1) when no monetary penalty is payable under subsection 162(1) or (2).

Miller J considered the minister's argument that certain extrinsic aids, including the technical notes that accompanied the introduction of subsection 162(2.1), indicated that the provision was meant to impose a penalty on all non-resident corporations that filed an income tax return late, regardless of whether any Canadian tax was owing in respect of the relevant taxation year. Miller J dismissed such arguments on the basis of the wording of subsection 162(2.1) and noted that

> [w]hile 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.[27]

27 *Goar*, supra note 24, at paragraph 11.

Miller J also commented on the manner in which penalty provisions in the Act should be interpreted:

> 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.[28]

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

As was the case in *Goar*, the Tax Court's judgment in *Exida.com* again focused on whether a late-filing penalty could be assessed against a non-resident corporation pursuant to subsection 162(2.1) when the non-resident had no Canadian taxes payable for the relevant year. The minister again made the same principal argument that he had made in *Goar*: a non-resident corporation may rightly be said to have been "liable to a penalty" under subsection 162(1), even if the penalty equated to $0 because the corporation had no Canadian taxes payable for the relevant year. However, the minister also argued, in the alternative, that subsection 162(7) should impose an equivalent penalty in respect of the taxpayers' failure to file Canadian income returns on a timely basis.

The taxpayers argued that a non-resident corporation is not subject to a subsection 162(2.1) penalty when it has no Canadian tax payable because the application of the penalty depends on the corporation being "liable to a penalty" under subsection 162(1) or (2), which in turn requires the corporation to have tax payable under part I of the Act. Furthermore, the taxpayers asserted that the objective of subsection 162(2.1) is to provide a greater penalty when a lesser penalty would otherwise be assessed under subsection 162(1).

The minister's alternative argument was dismissed by Woods J on the basis that subsection 162(7) applies only if no other provision of the Act sets out a penalty for failing to comply with the duty or obligation in question. In *Exida.com*, the taxpayers' obligation was the timely filing of Canadian income tax returns, and non-compliance with that obligation was penalized under subsection 162(1).

Despite the taxpayers' assertions, however, Woods J held that a non-resident corporation may be subject to a penalty under subsection 162(2.1) even when it has no tax payable for the relevant taxation year because the application of a subsection 162(2.1) penalty depends on the corporation being "*liable* to a penalty" (our emphasis), which in turn requires that a non-resident corporation be potentially subject to a penalty under subsection 162(1) as a result of its failure to file a Canadian income tax return in a timely manner.

28 Ibid., at paragraph 12.

Woods J determined that the case turned on the proper meaning of the word "liable" as used in subsection 162(2.1). She concluded that the word had a different meaning from the term "payable," which is used in more onerous penalty provisions in the Act. She also considered the technical notes that accompanied the introduction of subsection 162(2.1) and held that Parliament's objective in enacting the subsection was to "put teeth"[29] into the more restrictive filing requirements for non-resident corporations.[30] Accordingly, Woods J dismissed the taxpayers' interpretation of the objective of subsection 162(2.1) on the basis that "it is unlikely that Parliament enacted s. 162(2.1) for the modest objective"[31] of providing a small increase in the minimum penalty imposed on a non-resident corporation that has taxes owing in respect of a taxation year yet fails to file a Canadian income tax return on a timely basis.

On the basis of the foregoing, the taxpayers' appeals were dismissed and the minister's penalty assessments were upheld.

EXIDA.COM COMPARED WITH GOAR

The facts before the Tax Court in *Exida.com* were materially similar to the facts before the same court in *Goar*. Specifically, each of the three taxpayers (1) was a corporation resident in the United States that carried on business in Canada during the years in question; (2) failed to file a Canadian income tax return in a timely manner; (3) was assessed a $2,500 penalty under subsection 162(2.1) in respect of its failure to file a Canadian income tax return on time; and (4) had no Canadian income taxes owing in respect of the years for which it was assessed. Furthermore, in both decisions, the taxpayers and the minister were represented by the same agent or counsel, who made the same primary arguments before the Tax Court.

Despite the similar facts, Woods J and Miller J rendered opposing decisions in *Exida.com* and *Goar*, respectively. The primary distinction between the two analyses lies in the statutory interpretation of subsection 162(2.1), and specifically in the meaning of the phrase "liable to a penalty." In *Exida.com*, the issue turned on the meaning of the word "liable," which was found to be too broad a term to interpret in isolation. Accordingly, in applying a textual, contextual, and purposive approach to statutory interpretation, Woods J emphasized the technical notes as evidence of the legislative objective to be served by the enactment of subsection 162(2.1). Conversely, in *Goar*, the case appeared to turn on the court's finding that the language in subsection 162(2.1) was unambiguous and that extrinsic evidence, such as the technical notes, could not override such an interpretation. Miller J appeared to apply the following principles of statutory interpretation that have been articulated

29 *Exida.com*, supra note 23, at paragraph 58.

30 More restrictive Canadian income tax filing requirements for non-resident corporations were introduced in conjunction with the introduction of subsection 162(2.1).

31 *Exida.com*, supra note 23, at paragraph 58.

by the courts in the past: (1) where there is no ambiguity in the meaning or the application of the legislative provision to the facts, the provision should be applied, and references to the purpose of the provision cannot alter the unambiguous language of the provision; and (2) in cases of unresolvable interpretive ambiguity, there is a residual presumption in favour of the taxpayer.[32]

THE IMPLICATIONS OF THE CASES

The minister did not appeal the decision in *Goar*. Similarly, the taxpayers did not appeal the decision in *Exida.com*. It is important to note that *Exida.com* and *Goar* are informal procedure decisions of the Tax Court and, as such, do not constitute binding precedents.[33]

The contradictory decisions rendered in the cases have created uncertainty about whether a non-resident corporation that fails to file its Canadian income tax return in a timely manner is liable to a penalty under subsection 162(2.1) if no part I tax was payable in respect of the relevant taxation year. The decision in *Exida.com* is consistent with the technical notes to subsection 162(2.1); it aligns with the interpretation advanced by the CRA that a subsection 162(2.1) penalty applies regardless of whether Canadian tax is payable in respect of the year assessed; and it appears to be consistent with the French text of subsection 162(2.1).[34] Conversely, the decision in *Goar* is supported by the proposition that from a policy perspective, the onus should rest with Parliament to ensure that legislation is drafted clearly and precisely, so that taxpayers are able to fully comprehend their statutory obligations and arrange their affairs accordingly. The courts' consistent assertions that, in cases of ambiguity that cannot be resolved by reference to ordinary principles of interpretation, a vague or unclear provision should generally be interpreted in favour of the taxpayer reflects this enduring view of proper interpretive practice.

In the absence of definitive judicial guidance, non-resident taxpayers have been left in the unenviable position of attempting to guess whether future Tax Court judgments will embrace the policy-oriented analysis of Miller J or the purposive analysis by Woods J. While the very absence of a consistent judicial view regarding the application of subsection 162(2.1) seems to stand as prima facie evidence that the proper interpretation of the penalty provisions is far from clear, credible arguments can be made in support of both interpretive positions.

A non-resident corporate taxpayer that has recently been assessed a penalty under subsection 162(2.1) may wish to consider whether it would be prudent to file a notice of objection in response to the assessment.[35] Similarly, a non-resident corporate

32 See, for example, *Placer Dome*, supra note 10, at paragraphs 21-24.

33 Pursuant to the Tax Court of Canada Act, RSC 1985, c. T-2, section 18.28.

34 See, for example, *Pattee v. The Queen*, 94 DTC 1774 (TCC) (available in French only).

35 In some circumstances, a taxpayer may be entitled to ask the minister for a one-year extension in which to prepare and file a notice of objection.

taxpayer that has not been assessed a penalty for late-filing a tax return may wish to consider the possibility of filing a nil return under the CRA's voluntary disclosure program.

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ONTARIO SUPERIOR COURT OF JUSTICE

IS THE MINISTER A PROPER PARTY TO A RECTIFICATION APPLICATION?

Aim Funds Management Inc. v. Aim Trimark Corporate Class Inc.
2009 CanLII 29491 (Ont. SCJ)

KEYWORDS: RECTIFICATION ■ GST ■ LITIGATION

Aim Funds Management provides much needed guidance on the circumstances in which the attorney general of Canada (AGC) will be granted leave to intervene in a rectification application.

Rectification is an equitable remedy by which parties can correct mistakes in documents, with retroactive effect.[36] In the case of *Aim Funds Management*, the rectification application was precipitated by the minister of national revenue's reassessment of goods and services tax (GST). The applicant proposed to rectify certain agreements to reflect the parties' intention that deferred sales charges associated with mutual funds managed by the applicant were payable by investors rather than by the funds themselves. If the agreements were rectified, the deferred sales charges would not attract GST, thus nullifying the basis for the minister's GST reassessments.

The AGC sought to intervene in the application under rule 13.01(1) of the Ontario Rules of Civil Procedure[37] on the basis that it had an interest in the subject matter of the proceeding and would potentially be adversely affected by a judgment. Although rectification orders are obtained from provincial superior courts, they

36 The general requirements for obtaining a rectification order (as summarized in *A.G. of Canada v. Juliar et al.*, 2000 DTC 6589; [2001] 4 CTC 45 (Ont. CA); aff'g. 2000 DTC 5743; [2000] 2 CTC 464 (SCJ)) are (1) a prior agreement; (2) a common intention; (3) a final document that did not properly record the intention of the parties; and (4) a common or mutual mistake.

37 RRO 1990, reg. 194. Rule 13.01(1) reads as follows:

> A person who is not a party to a proceeding may move for leave to intervene as an added party if the person claims,
>
> (a) an interest in the subject matter of the proceeding;
>
> (b) that the person may be adversely affected by a judgment in the proceeding; or
>
> (c) that there exists between the person and one or more of the parties to the proceeding a question of law or fact in common with one or more of the questions in issue in the proceeding.