

Canadian Court Upholds Late-Filing Penalties for Nonresident Corporations

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FEATURED PERSPECTIVES

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A previous article analyzed the Tax Court of Canada's decision in *Goar, Allison & Associates Inc. v. Her Majesty the Queen*.¹ In *Goar*, the taxpayer, a nonresident corporation, successfully challenged the imposition of a late-filing penalty under subsection 162(2.1) of the Canadian Income Tax Act,² which was assessed on the basis that while no Canadian Part I tax was payable, the taxpayer had failed to file its Canadian income tax return in a timely manner.

Only a few months later, in *Exida.com Limited Liability Company v. Her Majesty the Queen*,³ the Tax Court of Canada revisited the issue of whether a late-filing penalty may be imposed under subsection 162(2.1) when a nonresident taxpayer had no Canadian taxes payable for the relevant year. In *Exida.com*, Justice Judith Woods came to the opposite conclusion of the court in *Goar*, holding that a 162(2.1) penalty should apply to nonresident corporations when they fail to file a Canadian income tax return on time even if they have no Canadian tax owing for the relevant year.

¹Michael Friedman and Ahsan Mirza, "Canadian Late-Filing Penalty Successfully Challenged," *Tax Notes Int'l*, July 13, 2009, p. 141, Doc 2009-13549, or 2009 WTD 131-14. *Goar, Allison & Associates Inc. v. Her Majesty the Queen*, 2009 D.T.C. 1125 (T.C.C. (Informal Procedure)) (*Goar*).

²1985, c. 1 (5th Supp.) and the regulations thereunder.

³2009 D.T.C. 1234 (T.C.C. (Informal Procedure)) (*Exida.com*). *Exida.com* was heard together with *Tonoga Inc. v. Her Majesty the Queen*.

Statutory Framework

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

To ensure that all nonresident corporations that may be subject to tax in Canada timely file Canadian income tax returns, the Canadian government introduced a special penalty provision that is solely applicable to nonresident corporations. Subsection 162(2.1) of the ITA provides that nonresident corporations that are "liable to a penalty" under subsection 162(1) 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 return was filed.

Subsection 162(2.1) subjects a nonresident corporation that files its Canadian income tax returns late to a penalty at least equal to the penalty imposed for the late filing of "information returns." Under subsection 162(7) of the ITA, a penalty may be imposed for a failure to timely file most "information returns" or to comply with a duty or obligation imposed by the ITA.

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 C \$2,500. Subject to certain exceptions, subsection 162(7) does not apply when another provision of the ITA “sets out a penalty for the failure.” The Canada Revenue Agency has historically asserted that a penalty under subsection 162(2.1) applies to a nonresident corporation even if no Canadian tax is owed by the taxpayer for the relevant year.

Facts

In *Exida.com*, the Tax Court of Canada heard together the appeals of two nonresident taxpayers, Exida.com LLC and Tonoga Inc., on the assessment of penalties under subsection 162(2.1) in respect of tax years for which neither taxpayer had Canadian tax payable.

The taxpayers were corporations resident in the United States that carried on business in Canada. Exida.com LLC provides training products and services to automation hardware manufacturers and process market end-users. Exida.com LLC carried on business in Canada during the 2003-2005 tax years and did not timely file Canadian income tax returns for each of the three years. Similarly, Tonoga Inc., a developer and manufacturer of advanced engineered composite materials, carried on business in Canada during the 2004 tax year and filed its Canadian income tax return late.

The minister of national revenue (MNR) assessed each nonresident corporation for the tax year(s) in which they carried on business in Canada on the basis that, while no Canadian Part I tax was payable, a late-filing penalty of C \$2,500 was payable under subsection 162(2.1) of the ITA.

Tax Court Judgment

The central issue in *Exida.com* was whether a late-filing penalty may be assessed against a nonresident corporation under subsection 162(2.1) when the nonresident 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 time, a nonresident corporation may rightly be said to have been “liable to a penalty” under subsection 162(1), even if the penalty was \$0 because the corporation had no Canadian taxes payable for the relevant year. As a result, the MNR concluded that the taxpayers were liable for penalties under subsection 162(2.1). In the alternative, the MNR argued that subsection 162(7) should impose an equivalent penalty for the taxpayers’ failure to timely file Canadian income returns.

The taxpayers argued that a nonresident corporation is not subject to a penalty under subsection 162(2.1) when it has no Canadian tax payable, because the application of a 162(2.1) penalty depends on the corpora-

tion being “liable to a penalty” under subsection 162(1) or (2), which requires the corporation to have tax payable under Part I of the ITA. 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 MNR’s alternative argument was summarily dismissed by Justice Woods on the basis that subsection 162(7) applies only when no other provision of the ITA sets out a penalty for the duty or obligation in question. In *Exida.com*, the taxpayers’ obligation was the timely filing of Canadian income tax returns, and noncompliance with such an obligation is penalized under subsection 162(1) of the ITA.

However, despite the taxpayers’ assertions, Justice Woods held that a nonresident corporation may be subject to a penalty under subsection 162(2.1) even when it has no tax payable for the relevant tax year, because the application of a 162(2.1) penalty depends on the corporation being “liable to a penalty,” which requires that a nonresident corporation be potentially subject to a penalty under subsection 162(1) as a result of its failure to timely file a Canadian income tax return.

In rendering her judgment, Justice Woods determined that the case turned on the proper meaning of the word “liable” as used in subsection 162(2.1), and concluded that the word has a different meaning than the term “payable,” which is used in more onerous penalty provisions in the ITA.

Justice Woods 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” into the more restrictive filing requirements for nonresident corporations.⁴ Accordingly, Justice Woods dismissed the taxpayers’ assertion as to 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” of providing a small increase in the minimum penalty imposed on a nonresident corporation that has taxes owing in respect of a tax year, yet fails to timely file a Canadian income tax return.

Based on the foregoing, the taxpayers’ appeals were dismissed and the MNR’s penalty assessments were upheld.

Exida.com Compared to *Goar*

The facts before the Tax Court of Canada in *Exida.com* were materially similar to those before the

⁴More restrictive Canadian income tax filing requirements for nonresident corporations were introduced in conjunction with the introduction of subsection 162(2.1).

same court in *Goar*. Specifically, Exida.com LLC, Tonoga Inc., and Goar, Allison & Associates Inc.:

- were corporations resident in the United States that carried on business in Canada during the years in question;
- failed to timely file a Canadian income tax return;
- were assessed a C \$2,500 penalty under subsection 162(2.1) of the ITA for their failure to file Canadian income tax returns on time; and
- had no Canadian taxes owing for the years for which they were assessed.

Further, in both decisions, the taxpayers and the MNR were represented by the same agent/counsel, who made the same primary arguments before the Tax Court of Canada.

Despite the similar facts and primary arguments, Justice Woods and Justice Campbell J. Miller rendered opposing decisions in *Exida.com* and *Goar*. The primary distinction between Justice Woods's and Justice Miller's analyses relates to the statutory interpretation of subsection 162(2.1) of the ITA; specifically, 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 and, accordingly, emphasis was placed on the Technical Notes as evidence of the legislative objective to be served by the enactment of subsection 162(2.1) of the ITA. Conversely, in *Goar*, the case appeared to turn on the court's finding that a penalty must be represented by a positive monetary

amount and extrinsic evidence, such as the Technical Notes, could not override such an interpretation.

Implications of *Exida.com*

Exida.com LLC and Tonoga Inc. have chosen not to appeal the decision rendered by the Tax Court of Canada.* Note that *Exida.com* and *Goar* are informal procedure decisions of the Tax Court of Canada, and, as such, the decisions do not constitute binding precedents under section 18.28 of the Tax Court of Canada Act.

The contradictory decisions in *Exida.com* and *Goar* have created uncertainty as to whether a nonresident corporation that fails to timely file its Canadian income tax return is liable to a penalty under subsection 162(2.1) when no Part I tax was payable in respect of the relevant tax year.

Despite the adverse finding in *Exida.com*, nonresident corporate taxpayers that have recently been assessed for penalties under subsection 162(2.1) of the ITA may still wish to consider whether it would be prudent to file a notice of objection in response to any such assessment. Under subsection 165(1) of the ITA, a notice of objection may be filed on or before the day that is 90 days after the date of mailing of the relevant notice of assessment.⁵ ◆

⁵Under 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.



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