

TAX ALERT



TAX ALERT is a commentary on topics of current interest – usually topics relating to recent changes in tax law, new CRA administrative practices or current interpretations arising from tax cases. Professional advice should be obtained before acting on any of this information.

TAXPAYER RELIEF, REFUNDS AND AMENDED TAX ELECTIONS

In 2007, Canada Revenue Agency (CRA) issued a comprehensive Information Circular IC 07-1 to let taxpayers know when and how they can ask for relief from the normal collection, re-filing or refund provisions of the Income Tax Act. Knowledge of these rules can be extremely helpful to taxpayers who owe or potentially owe significant amounts of money to CRA or are looking to get refunds that they are otherwise statute barred from receiving. The Circular deals with four main areas:

- ◆ Request for taxpayer relief – cancellation or waiver of interest and penalty charges
- ◆ Filing a voluntary disclosure to eliminate penalties on unreported income
- ◆ Obtaining refunds beyond the three year limit normally allowed
- ◆ Filing, amending or withdrawing special tax elections beyond permitted time limits

The Minister does not have to grant relief in any of the above areas and each request will be reviewed by CRA and decided on its own merit. If CRA denies an adjustment, they will also provide the taxpayer with an explanation of the reasons for their decision. A second appeal to the local tax office is then possible.

Time Allowed for Application

The Minister may grant relief for any tax year that ended within 10 years before the calendar year in which the taxpayer's request is filed. Therefore, a taxpayer has 10 years from the end of the calendar year in which the tax year ended to make a request to the CRA for relief. This 10 year limitation period rolls forward every January 1. Relief from interest charges relating to tax matters that arose more than ten years ago will not be allowed. *Cancellation* of interest refers to the elimination of interest already accrued whereas a *waiver* of interest refers to cancellation of future interest charges.

Request for Taxpayer Relief

In determining whether to waive or cancel interest charges, CRA will consider a number of factors:

- ◆ Whether the taxpayer has a history of compliance
- ◆ Whether the taxpayer knowingly allowed a balance to exist on which interest has accrued
- ◆ Whether the taxpayer has exercised reasonable care and has not been negligent or careless in filing tax returns
- ◆ Whether the taxpayer has acted quickly to remedy any delays or omissions.

Taxpayer relief for interest (and less often penalties) may be warranted in three situations outlined by CRA as follows:

- ◆ *Extraordinary circumstances*
 - ◆ Natural or man-made disaster
 - ◆ Death / accident / serious illness / emotional or mental distress
 - ◆ Civil disturbance
- ◆ *CRA actions*
 - ◆ CRA error
 - ◆ CRA delay
- ◆ *Inability to pay*
 - ◆ Financial hardship / inability to pay

The request for relief is normally applied for using form RC4288E accompanied by a detailed supporting submission and backed up by appropriate documentation. A taxpayer can make this application based on any one or more than one of the three situations.

Extraordinary circumstances apply for reasons beyond the taxpayer's control. For example, the inability to file a tax return because of serious illness, accident or serious emotional or mental stress all qualify. Actions caused by CRA would include such things as processing delays, or undue delays in resolving an objection or appeal or completing an audit. Errors in materials available to the public from CRA or incorrect information provided to a taxpayer also qualify as a CRA action that cause interest to be payable.

The inability of a taxpayer to pay or financial hardship can involve several different situations. The Circular lists the following examples:

- ◆ Where a collection has been suspended due to an inability to pay
- ◆ Where a taxpayer can show that the inability to pay requires an extended payment arrangement
- ◆ When payment of accumulated interest would cause a prolonged inability to provide the basic needs of life such as food, medical assistance, transportation, shelter etc.

Voluntary Disclosure

As most people know, CRA operates a Voluntary Disclosure program that allows taxpayers to come forward and correct inaccurate information already filed with CRA or omitted. In such cases, taxpayers will have to pay the taxes owing plus arrears of interest but CRA will waive penalties and prosecution that might otherwise occur. CRA may also provide some relief on a case by case basis on interest arrears after the taxpayer has made the voluntary disclosure.

A Voluntary Disclosure is only valid where it has been made before a CRA review or other investigation is under way which would include a simple request by CRA to file a tax return. Information Circular IC00-1R2 deals with Voluntary Disclosure in detail and this area will not be further dealt with in this article.

Taxpayers should understand that CRA has extraordinary powers to track down information that will disclose unreported income. For example, most of Canada's tax treaties with other countries provide

for an exchange of information between tax authorities and this process is being used more frequently.

Obtaining Refunds

The normal time to make a claim for a tax refund is three years from the date of the Notice of Assessment for the year or three years from the end of the year if a return was not filed. Often, taxpayers are unaware of this three year limitation and consequently refunds may not normally be available if notices of objection or returns have been filed more than three years late. However, the Income Tax Act does grant the Minister discretionary authority to accept such late requests if they are made within the 10 year period. Individuals can make such a request if they were not aware that they missed claiming a deduction or a refundable or non-refundable tax credit was not applied for on the original return.

Refund claims are often overlooked simply because a taxpayer has no tax payable and therefore does not file a tax return. Refundable tax credits such as the child tax credit or GST credit are payable to the taxpayer even with no tax payable so a return should always be filed. Non-refundable credits such as the disability tax are also often overlooked. Ten years of disability tax credits not applied for amount to over \$10,000.

In the case of corporations, there can be unclaimed balances due to taxpayers in accounts that CRA has closed because of inactivity. Christian Belanger has written a comprehensive booklet about this in a *Guide for a Detailed Review of Tax Accounts of Canadian Companies*. It can be found at www instalment-account.com.

Filing, Amending or Withdrawing Special Tax Elections

The Income Tax Act often allows taxpayers to make special elections to obtain an alternate tax treatment from the norm. For example, an election to defer income could make a transaction tax free until years later. The Income Tax Act gives the Minister discretion to extend the statutory time for filing such elections or permit elections to be amended or revoked. These requests must still be made within the 10 year time period.

If a late filing election is accepted, a late filing penalty is imposed. Therefore, taxpayers need to consider if the benefit of the late filed election exceeds the cost of the penalty and gives them a positive result. In many instances that will be the case.

CRA lists a number of situations in which late, amended or revoked elections are permitted:

- ◆ There have been tax consequences not intended by the taxpayer and the taxpayer took reasonable **steps** to comply with the law
- ◆ The request arises from circumstances beyond the taxpayers control
- ◆ The taxpayer acted on incorrect information given by CRA
- ◆ The request results from a mechanical error by the taxpayer
- ◆ The taxpayer can show that they were not aware of the election provision even if they took a reasonable amount of care to comply with the law and took remedial action as quickly as possible

Circular IC 07-1 provides an extensive list of specific elections that can be filed late. There are too many to list here and advice should be sought if you think you missed an election. Some of the obvious ones are as follows:

- ◆ An election to capitalize interest cost instead of deducting it
- ◆ An election to defer the income or capital gain when a replacement property is acquired for a property that was stolen, expropriated, destroyed or a former business property
- ◆ An election to designate a property as a principal residence **because** there has been a change of use to an income producing property
- ◆ An election to have a bad debt deemed to be disposed in the year and reacquired to permit a capital loss deduction
- ◆ An election to have the tax free roll over rules not apply on the transfer of assets to a spouse
- ◆ An election to have the tax free rollover reserves on the transfer of property to spouse or common law partner not apply
- ◆ An election **to** allow the taxpayer to have a taxable dividend from a Canadian corporation by a spouse or common law partner included in the taxpayer's income
- ◆ An election that allows a private corporation **to have a taxable dividend** treated as a tax free capital dividend
- ◆ An election to have an excess capital dividend **treated** as a taxable dividend

Space does not allow a detailed discussion of the above but be assured that any one of the elections could be beneficial to you in the right circumstances. Tax filings are best done with pre planning but tax savings can also be there by filing or re-filing or withdrawing a late election.

Summary

The Circular certainly allows a taxpayer to reduce interest and penalties and obtain tax refunds retroactively but the procedures can be a bit of a cage match. The odds aren't quite as bad as playing blackjack at the casino but still can be a bit like a root canal procedure. **First** get advice to see if you can benefit. If you can't get help and are confused whether or not you qualify, do the paperwork to the best of your ability, quote circular IC 07-14 as your authority, file your amendment and hope for the best. CRA is usually quite helpful as long as they get your request on time. *This article first appeared in Canadian MoneySaver magazine.*

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