



CESTNICK

TAX MATTERS

Be careful to avoid paying someone else's taxes

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You've probably heard the definition of a tax expert. It's someone who tells you about a problem you didn't know you had, fixes it in a way you don't understand, and charges a fee for it. Among the unpleasant tax surprises people encounter is one that pops up from time to time in tax court. In fact, there were two judgments handed down by the courts on Feb. 1 dealing with the same issue. I'm talking about Section 160 of our tax law, which can leave you on the hook for someone else's taxes. Let me share the stories.

Story One

The case *Pacheco v. The King* (2024 TCC 14) is about a married couple where the wife, Mrs. P, was reassessed for taxes owing by her husband, Mr. R. The reason? Mr. R owed income taxes at a time when he transferred funds to Mrs. P.

Now, Section 160 of our tax law says that where a person transfers property to their spouse (or another non-arm's length person) without being paid for that property, the recipient is jointly and severally liable for the transferor's tax debt – up to the value of property that

was transferred. If the recipient pays something (called "consideration") for the property received, then the taxes owing by the recipient will be reduced by the value of the consideration.

Back to the Pacheco case. Mrs. P received payments totalling \$82,055 from Mr. R at time when he owed more than this in income taxes. Mrs. P conceded that \$34,305 was a gift to her and that Section 160 should apply to this amount, but that the remaining \$47,750 was actually a repayment of funds owing to her for amounts she had lent to Mr. R.

Specifically, here's what was testified in court: Mrs. P owned a corporation that paid her fees regularly for work she did in the business. Rather than paying her cash, it was explained that her fees were recorded as amounts owing to her by the company. She would then draw down on that shareholder loan balance as she needed cash.

From about January 2013, to May 2014, the company issued cheques to Mr. R totalling \$47,750. Mr. R stated that these cheques were a repayment of shareholder loan amounts owing to Mrs. P. In effect, Mrs. P was lending these

amounts to Mr. R – although there was no loan documentation around this.

So, when Mr. R paid the \$47,750 to Mrs. P, it was explained that this was a repayment of amounts she lent to him. If this had been the case, then the “consideration” test would have been met; her earlier loans to him would have effectively been consideration for the amounts received from Mr. R, and Section 160 would not apply.

The Tax Court of Canada judge, Susan Wong, didn’t buy this: “I am unable to conclude from Mr. R’s oral testimony and the limited documentary evidence that the cheques were loans to him from the appellant, and that his deposits to her bank account were in turn repayments to her” the judge said.

As an aside, Mrs. P didn’t testify in court. Mr. R alone – who is an accountant – appeared in court and explained everything. The judge noted that it would have been helpful to hear Mrs. P’s testimony in her own words to support the account provided by Mr. R. Mrs. P’s appeal was dismissed and she owed taxes of \$82,055, plus court costs.

Story Two

The case *Pillon v. Canada* (2024 FCA 24) was tried at the Federal Court of Appeal. In this story, Mrs. P (a different Mrs. P than the one in the first story) had received property worth \$978,900 from Mr. W at a time when he owed tax debts of about double that amount.

In this case, Mrs. P argued that Section 160 should not apply because (1) she gave full consideration for the property received, and (2) she dealt at arm’s length with Mr. W. The FCA ruled against Mrs. P on both counts. Mrs. P and Mr. W were not married, but said they were “friends.” However, the judge found that they acted in concert without separate interests, noting that they had a “close personal relationship.”

In order to escape Section 160, you have to show that one of the following is true: (1) the transferor wasn’t liable for taxes at the time of the transfer, (2) there was no transfer of property, (3) you deal with the transferor at arm’s length, or (4) you paid sufficient consideration for the property transferred.

The bottom line? If you ever receive something of value from another person and you suspect that they could owe taxes, be sure to ask about it, and make note of the four factors that might leave you stuck paying their tax bill.

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