



# KRAFT BERGER LLP

Chartered Professional Accountants

## Tax Letter

February 2023

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### SHAREHOLDER AGREEMENTS

Whenever a private corporation has shareholders from more than one family (and sometimes even within the same family), a shareholders' agreement should be considered.

A typical situation is where two or three individuals go into business together, and incorporate their business, with each one owning an equal or unequal number of shares of the corporation.

If you do not have a shareholders' agreement, the normal rule is that a majority of the voting shares can elect the board of directors, and the board of

directors can do pretty much what they want with the management of the company. Whoever controls the board controls the business. A minority shareholder might just as well have no votes at all. (In some cases, there is Court action that can be taken if the minority shareholder is being unfairly treated, but this is uncertain, slow and expensive.)

A shareholders' agreement (sometimes called a Unanimous Shareholders' Agreement) can protect minority shareholders and allow the parties to deal in a planned way with various contingencies that can arise. It can become quite a complex document, as there may be many conditions to plan for.

Some of the issues that a shareholders' agreement can cover are the following:

- Control of the corporation: who will be on the board? A minority shareholder can be guaranteed one or more seats on the board of directors. The agreement can also guarantee that specific individuals will hold specific positions as officers of the company, such as President or Treasurer.
- What happens if a key player dies, becomes disabled, or wants out of the business? The agreement can provide a

mechanism for the remaining shareholders to buy the departing shareholder's interest, and a method of valuing that interest.

- What if the key owners no longer get along? For a two-shareholder company, one solution is a "shotgun" arrangement. Either owner ("A") can at any time trigger the shotgun by offering a price for the shares of the other ("B"). B then chooses between selling their shares for that price or buying A's shares for that price. This keeps A honest: if the offer is too low, B will simply take A's shares at a low price, while if the offer is too high, B will sell out and take the cash.
- Options to acquire more shares from the corporation at a pre-specified price.
- Compensation and incentives such as bonuses. These are normally decided on by the directors, but a shareholders' agreement can override this, or can set limits.
- Tax issues, such as ensuring that the corporation's capital dividend account (which allows certain amounts of dividends to be paid out tax-free) is used fairly; or maintaining the corporation's assets in a way that will qualify for the capital gains exemption if shareholders sell their shares.
- Insurance. Should the corporation hold, and pay for, life and disability insurance on the key owners? Should the owners cross-hold policies on each other's lives, so that if one dies the other will have funds to buy the deceased owner's shares from the estate? Should the directors be insured against liability, including for unremitted income tax

source deductions and unremitted GST/HST?

- What happens if an offer comes along from a third party to buy out the controlling shareholder? The agreement can provide that the controlling shareholder can only accept if the minority shareholders are given the same offer. It can also provide rights of first refusal, so that other shareholders would have the option of matching the third party's offer.
- Transfers of shares normally require approval of the directors or shareholders of the company. The agreement can provide that such approval is guaranteed for certain kinds of transfers (e.g., to family members, a holding company or a family trust).
- Dividends. Without an agreement, the board of directors has the discretion to declare whatever dividends they want (provided the company is solvent) — or no dividends at all. The agreement can require minimum dividends based on specific levels of profitability or can require that certain amounts be reinvested in the business.

Obviously, there is a vast range of possible considerations for shareholders' agreements. The above points highlight only some of them. Anyone entering a new corporate venture should seriously consider such an agreement. Although they are time-consuming and expensive to negotiate and draw up, they help focus the parties up-front on some of the issues that are likely to arise during the life of the business. Without such an agreement, disputes between the parties may become unresolvable.

There are many tax planning issues relating to shareholder agreements as well. For example, the existence of an agreement can change the “control” of the corporation for tax purposes. This can affect its status as a Canadian-controlled private corporation, whether it is “associated” with other corporations for purposes of the small business deduction, and many other things. Careful analysis of all the tax implications is crucial when designing a shareholders’ agreement.

### WHAT IF YOU DISAGREE WITH THE CRA?

What do you do if the Canada Revenue Agency issues you an income tax or GST/HST Notice of Assessment (or Reassessment), and you believe the CRA is wrong and that you should not be paying so much?

#### *The CRA’s role*

As you may know, the CRA doesn’t create the law. The rules for our income tax system are set out in the *Income Tax Act*, as amended by Parliament every year. Similarly, the GST and HST rules are enacted in the *Excise Tax Act*. The Department of Finance Canada is responsible for designing and drafting changes to these Acts.

The CRA’s job is to administer and enforce the system. As such, **the CRA is bound by the law**. However, sometimes the Agency’s interpretation of the law is different from that of taxpayers and can successfully be challenged. CRA auditors often make technical mistakes, as the legislation is very complex. Even more often, the CRA reviewer or auditor may not have properly understood the facts of your case.

#### *Objection (appealing within the Canada Revenue Agency)*

The first step is to make sure that you **understand the rules** of the *Income Tax Act* or *Excise Tax Act* as they apply to your problem. Sometimes, even though the rules seem unfair, they are being correctly applied. If the rules are clear, then no matter how much you dislike paying the extra tax, you may have no choice.

**Don’t hesitate to get professional advice** at this stage. An hour spent with an expert tax accountant or lawyer will be well worth it, if as a result you can know whether the assessment is simply a clear application of the law, or whether you have a realistic chance on objection or appeal.

The next step is to contact the CRA and request an adjustment. Sometimes a phone call can help iron out your problem and clarify the issues, though you may wish to put your request in writing. You can request adjustments online using [cra.gc.ca/myaccount](http://cra.gc.ca/myaccount).

However, you will need to file a **Notice of Objection** before the deadline for doing so expires. This can be done online or on paper. The deadline is **90 days** from the date of sending the notice of assessment or reassessment to which you are objecting (or, for personal income tax, one year from the original April 30 or June 15 deadline for filing the return in question, if that is later). The date showing on the Notice of Assessment is normally presumed to be the date of sending it (*Income Tax Act*, subsection 244(14)).

Even if you are negotiating a solution and CRA officials have agreed orally or in writing to your position, **you should file a Notice of Objection if the deadline is**

**approaching** and no reassessment has been issued to your liking. Otherwise, you lose your legal right to appeal. The CRA's promise to correct an assessment will not be binding until the reassessment is actually issued.

Within about 6-12 months after you file the Notice of Objection, your case will be assigned to an **Appeals Officer**. (The terminology is confusing here: you have filed an *objection*, not an *appeal*, but it is an "Appeals Officer" who considers your *objection*.) This officer is internal to the CRA but is independent of the Audit section that issued the reassessment. Thus, your case should be given a "fresh look" by someone who has no preconceptions as to the result. However, if at this stage you provide new documents that the auditor had requested from you and not received, the Appeals Officer may be required to send the file back to the auditor to review those documents and analyze them for the Appeals Officer.

The Appeals Officer is required by CRA administrative policy to give you a copy of the auditor's working papers and other documents in the file (except confidential material relating to third parties, or any legal advice the CRA received that is protected by solicitor-client privilege).

You can also file a request for a copy of the entire file under the *Privacy Act* by contacting the Access to Information and Privacy (ATIP) Office of the CRA and making a request online. It can be very useful to get copies of all correspondence, memos, email, and analysis engaged in by the auditor and other persons the auditor may have consulted. (If your business is incorporated, so that the taxpayer that was assessed is a corporation, the same

information is available, for a \$5 fee, under the *Access to Information Act* rather than the *Privacy Act*.)

You can speak to the Appeals Officer and try to convince him or her of the correctness of your position, or you can make your case in writing, as you should have already done in the Notice of Objection. There is no formal "hearing". Dealing with the Appeals Officer is similar to dealing with an auditor who is proposing a reassessment.

If the Appeals Officer agrees with you, the reassessment will be "vacated", or will be "varied" to reflect your position (and a new reassessment issued), and that is the end of the matter. If not, the reassessment will be "confirmed". You will thus receive a Notice of Decision or Notice of Confirmation by registered mail, or in some cases on your online account. At this point you have exhausted your routes of appeal within the CRA and must resort to the courts if you are still not satisfied.

### *Appealing to the Tax Court*

You have **90 days** from the day the Notice of Confirmation or Notice of Decision is sent to you to appeal to the **Tax Court of Canada**. If you miss the deadline, an extension of up to one year *may* be available but only if certain conditions are met. After the one-year extension, you are completely barred from appealing.

If the amount at stake involves less than \$25,000 in total *federal* tax and penalties for any given taxation year, not counting interest, you may choose to use the Tax Court's **Informal Procedure**. (Including provincial

tax and interest, this usually covers disputes of up to about \$40,000-\$50,000 per taxation year assessed.) Otherwise, unless you give up your right to appeal the excess, you are required to use the court's **General Procedure**.

The Informal Procedure is informal in terms of paperwork, but there is still a formal **hearing** before a judge in a courtroom. (The Tax Court has courtrooms in cities across Canada.) You can simply write to the Tax Court to say that you are appealing, through using their standard Notice of Appeal form or filing online is advisable. You can file your appeal online at [www.tcc-cci.gc.ca](http://www.tcc-cci.gc.ca). There is no filing fee. You do not need to retain a lawyer, though you may if you wish. Many taxpayers want their accountant there to present their case.

An Informal Procedure hearing is still quite formal and follows a set format. After each side makes a brief opening statement, you must present all your evidence by giving sworn testimony, plus any other witnesses that you bring. You and other witnesses giving evidence will be cross-examined by the Department of Justice lawyer representing the Crown (the CRA). Then the Crown presents any evidence they have, and you (or your representative) can cross-examine their witnesses. Then you make your legal argument, based on the evidence presented. Then the Crown makes its legal argument. Finally, you have a rebuttal. (During the argument phase, no new evidence can be presented, though the judge can bend this rule if he/she wishes.) In theory, you are supposed to receive a decision within 12 months of filing your appeal, but it often takes longer, especially since the Court is still recovering from the backlog caused by COVID.

For the General Procedure, you should retain a lawyer. (Technically, you can act for yourself, but given the complex court rules and procedures involved, this is not advisable.) A case under the General Procedure can easily take two years or more to get to trial, and even longer before the judge issues a decision.

Note that the appeal is *only* about whether the assessment is correct. If the CRA auditor or Collections officer acted unreasonably towards you, that doesn't matter, and the Tax Court will take no notice of such evidence.

For more information on appealing, see the Tax Court's web site at [www.tcc-cci.gc.ca](http://www.tcc-cci.gc.ca).

*Do you pay the balance owing?*

In general, while your case is under objection or under appeal to the Tax Court, you cannot be forced to pay the balance owing (there are some exceptions to this rule). Interest will continue to accrue on the unpaid balance, however; the current rate is 8%, compounded daily (the rate changes every quarter). This interest is non-deductible.

*Should you pay anyway?*

If you believe that your case is likely to lose, *or* if you have the funds available, it is usually a **good idea to pay the balance**. That will stop the non-deductible interest from accruing in the event you lose. And if you win, you will receive refund interest (currently at a rate of 6% compounded daily for taxpayers that are not corporations) when the overpaid balance is refunded to you.

**Paying the balance has no effect on the outcome of the case.** Neither the Appeals Officer nor the Tax Court will consider it an

admission of liability. In fact, neither the Appeals Officer nor the Tax Court will normally even be aware of whether you have paid or not. Collections and Appeals are quite separate departments within the CRA.

Note that if you have a GST/HST assessment, or an assessment relating to source deductions (such as payroll) that were withheld and not remitted, there are no restrictions on CRA collection action, and the CRA will normally take action to collect the balance even while the assessment is under objection or appeal. (It is possible to get Collections officers to use their discretion to hold off on collection action, if you appear to have a good case and it appears that you will still have assets after the case is resolved.)

#### *Beyond the Tax Court*

After the Tax Court of Canada has given its decision, either you or the CRA can appeal to the Federal Court of Appeal. An appeal can be brought only on matters of law; you cannot appeal the judge's findings of fact (such as whether any evidence you gave was credible), unless you can show that the judge made a "palpable and overriding error", which in practice is almost impossible to do. It typically takes over a year from the time an appeal is filed until the Federal Court of Appeal gives its judgment.

In rare cases, an appeal from the Federal Court of Appeal will be heard by the Supreme Court of Canada. That Court accepts appeals only on matters it considers to be of national importance, and typically considers only four or five tax cases a year. You must apply to the Supreme Court for "leave to appeal". A panel of three justices of the Supreme Court will consider your written application and decide whether the

appeal should be heard. Even then, of course, that is no guarantee the appeal will be allowed—it just means that you will be permitted to present your case to the Supreme Court.

#### *Administrative Appeals — The "Taxpayer Relief Package"*

There is one set of rules that are within the CRA's **discretion**, and for which you cannot file a Notice of Objection or appeal to the Tax Court. These are part of the Agency's "**Taxpayer Relief package**" (formerly called "Fairness").

The "Taxpayer Relief package" has a number of components. One of them allows the CRA to **reopen your return and issue a reassessment to reduce your taxes for any past year**, going back up to 10 years from the year you apply. If, for example, you discover that you neglected to claim a credit or deduction that you could have claimed six years ago, you can apply to the CRA to reassess your return for this purpose. Once 90 days have passed from the original assessment, and one year has passed from the original due date for the return, you cannot file a Notice of Objection and so you cannot force the CRA to do this. But in many cases the Agency will honour your request, particularly where the failure to make the claim was a result of an oversight on your part. (Your request will generally not be allowed if what you are doing is considered to be retroactive tax planning.)

Another element of the Taxpayer Relief package allows the CRA to **waive or cancel interest and penalties**, again provided you apply within 10 years of the taxation year during which the interest accrued. Interest is automatically added to payments of tax or instalments that are not made on time and is

compounded daily. Penalties are also applied in certain cases. The CRA may waive these if you can fit into the Agency's guidelines under its Information Circular ([07-1](#)) relating to waiver of interest and penalties. Grounds for waiver include:

- a serious illness or accident that prevented you from filing or making a payment on time
- serious emotional or mental distress, such as caused by illness or death in the immediate family
- disasters such as a flood or fire
- civil disturbances or disruptions in services, such as a postal strike
- processing delays that resulted in you not being informed, within a reasonable time, how much was owing
- incorrect information that you received from the CRA
- "financial hardship": your inability to pay the total owing due to the amount of accrued interest.

Note that the CRA cannot waive the amount of *tax* you owe; the waiver applies only to the interest and penalties.

A request for Taxpayer Relief can be made on [Form RC4288](#), by writing a letter, or online from your CRA "My Account" or "My Business Account".

If you are unhappy with the CRA's decision on a Taxpayer Relief issue, you can ask for a "second review", which is undertaken by different officials within the CRA. If you are still unhappy with the next decision, you can **apply to the Federal Court for "judicial review"** of that decision. This can be done on your own, though it would be wise to consult a tax lawyer, and to retain a lawyer to handle the application if the amount involved is substantial. (In this process, you provide your evidence by way of Affidavit;

you cannot actually give live evidence.) However, the Federal Court normally cannot substitute its judgment for that of the CRA. It will only grant relief if you can show that the CRA's decision was **unreasonable** — for example, the CRA did not explain the reasons for its decision or did not act with procedural fairness. If the CRA's decision was "transparent, intelligible and justified" (the *Vavilov* test, from a 2019 Supreme Court of Canada decision by that name), you are out of luck. Even if you win, the best the Federal Court can normally do is to send the matter back for a further review by different CRA officials.

If you are considering a Federal Court application, note that the timeframe for filing the application is very short — normally 30 days from when the CRA issues its second-level decision (*Federal Courts Act*, section 18.1). Note also that it may be useful, once you have started the application process so that you have met the deadline, to file a *Privacy Act* request as discussed above to get a copy of the CRA's file on your Taxpayer Relief request. That will allow you to know the reasons why the CRA reached the decision it did, and to provide evidence and argument to respond to those reasons.

### *Remission Orders*

By law, neither the CRA nor the Courts can cancel tax that is legally owing. However, there may be unusual circumstances where it is unfair for you to have to pay.

For example, one such situation might be where you relied on CRA misinformation to your detriment, and tax became payable as a result where it would otherwise not have been payable.

In rare cases, it is possible to obtain a **remission order** that cancels tax. A remission order is actually an Order-in-Council passed by the federal Cabinet.

### **DON'T DO TOO MUCH TRADING IN YOUR TFSA!**

As is well known, the Tax-Free Savings Account (TFSA) rules allow you to invest a substantial amount of money in a TFSA, and all interest, dividends and capital gains earned in the account are tax-free.

For 2023, another \$6,500 is added to the amount you can contribute.

The age of eligibility for the TFSA is 18. It started in 2009 (with \$5,000 being the maximum contribution that year and now it is \$6,500). The cumulative contribution is \$88,000 in 2023 for people who were at least 18 in 2009.

You can withdraw funds from a TFSA at any time with no tax cost, and the amount you withdraw becomes available to re-contribute, but **only from the following January 1**. If you re-contribute too soon, a penalty tax applies.

Do not swap securities in or out of your TFSA, i.e., in exchange for money or securities in other investment accounts. Severe penalties apply to a “swap transaction”.

**Do not do too much active trading** in your TFSA. If you buy and sell securities regularly, the TFSA may be considered to be “carrying on business”, and then it loses its tax exemption and you will have to pay tax, as a trust, at the highest tax rate that applies to individuals (something in the 50% range, depending on your province of residence). Also, you will be *personally* liable for that tax, so the CRA can assess you to collect it

if the TFSA doesn't have sufficient assets to pay.

The line between owning stocks as capital investments and holding them for trading as a business is not always clear. At one extreme, if you buy or sell a stock once a month there should be no problem. At the other extreme, if you are trading almost every day and holding stocks for only a few days at a time, that will be considered carrying on business and the TFSA will be taxed.

So be careful about this!

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This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with an expert before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.