Vol. 20 No. 4 **June 2017**

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Marmer Penner Inc. Newsletter

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Reassessed Income Tax as a V-Day Liability

One draws very skeptical views about the honesty of the typical Canadian taxpayer when one practices business valuation for matrimonial purposes. It seems a disproportionate number of cases that land on our desks involve unreported income, fabricated expenses and hidden assets. As officers of the court and chartered accountants, it is our duty to recommend that a taxpayer who has been less than forthright with Canada Revenue Agency ("CRA") make a voluntary disclosure. It may also be the prudent approach from a matrimonial litigation standpoint. Your client would be unwise not to heed your advice for the following reasons:

(a) Going into court without "clean hands" puts that spouse at a disadvantage as far as the court's likely view of him/her;

(b) The voluntary disclosure allows the spouse to avoid penalties as CRA promises to waive these if full disclosure is made before CRA had commenced an investigation;

(c) Crystallizing the tax liability at the valuation date allows the tax-delinquent spouse to share the liability as it reduces his/her NFP;

(d) Except in unique circumstances, only a fool believes that his/her former spouse will never turn him/her in after the case settles. There is no statute of limitations for tax evasion and former spouses tend to anger easily at one another; and

(e) For support purposes, the voluntary disclosure may eliminate the income tax gross-up often applied to increase the support-payer's income.

In one case, years ago, we acted for the non-title spouse. The husband owned a chair manufacturing business and our client was the corporate bookkeeper but not a shareholder. The issue was his income for support purposes and the only question was the extent of unreported sales. Both admitted to a level albeit his was lower than hers. We cautioned our client that the judge might not take kindly to either since both participated in the tax fraud. In the *Paluzzi* decision, the court released its decision to both the clients and CRA simultaneously.

What about the situation where the spouse is reassessed after the date of separation but for income earned prior to separation? One would think that since that income was shared with the other spouse that it would be fair to share the related liability even if it came to light after V-Day. After all, it is likely that the liability existed and would have been determined if due diligence had been performed at that date. However, in a recent Ontario Superior Court case, *Cosentino*, the judge found otherwise. There were two minor NFP issues to be decided. The husband was a commissioned salesperson who had all but virtually earned a commission prior to V-Day but the deal did not close until after. The judge found that this expected commission although not yet legally owing was still “property”. The second issue was the allowance of an income tax liability on reassessment. The parties separated in late 2007 and, in March 2008, CRA contacted the husband to arrange a review of his 2005 and 2006 income. The court concluded that the liability arose on one of the date of the reassessment notice, the date the audit began or the date the husband was initially contacted. Since all of these were post-V-Day, the liability could not be considered.

If the issue was a corporate tax issue, one might argue that proper due diligence would have found this so a reasonable buyer would have paid less for the shares of such a corporation. Mr. Cosentino may have been treated unfairly but if you take the time to read the entire decision, he wasn’t the nicest fellow…