

Marmer Penner Inc. Newsletter

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Undisclosed Income Tax Liabilities

There is no shortage of clients with unreported income or personal expenses improperly charged as business expenses. It is not exactly front-page news that unreported income and personal expenses have a significant impact on the determination of income pursuant to the *Federal Child Support Guidelines*. But, is the impact on business valuation and net family property (“NFP”) as clear?

If we have a client with unreported income or significant personal expenses charged as business expenses, we advise them to make a voluntary disclosure to Canada Revenue Agency (“CRA”). We do so for a number of reasons not the least of which is our duty as chartered accountants to recommend that our clients obey the law. Also, if all or most of any accrued tax liability from years of the aforementioned unreported income or significant personal expenses arose during the marriage, the cost of making a voluntary disclosure to CRA is halved as the tax liability will reduce the client’s NFP.

So, is a post-V-Day reassessment which pertains to a pre-V-Day infraction always accepted as a reduction of NFP? In a 2015 Ontario Superior Court case, *Cosentino* (2015 ONSC 271), the judge found otherwise. The issue was the allowance of an income tax liability on reassessment. Mr. Cosentino was a commissioned salesman. 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 dates 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. No details of the reassessment were provided but it is likely that it related to either an under-reporting of commission revenue or exaggerated business expenses. Given that the benefits of Mr. Cosentino’s failure to report the proper amount of taxable income in 2005 and 2006 presumably left more in the parties’ bank account, both spouses benefitted equally from it. Accordingly, we would have expected the liability to be considered in the NFP calculation.

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.

More recently, in *Colivas* (2017 ONSC 4730), the decision opened with reference to “the Respondent husband’s decision to deceive the Applicant wife and the court”. However, as you will read, Mr. Colivas may have gotten off lightly as the decision explained that the Applicant wife “as a witness determined to promote her desired narrative”. The valuation date was in mid-2011. In or around 2009, Mr. Colivas drew \$331,000 from his company, Cedar Creek, without reporting it as personal income. He never made a voluntary disclosure to CRA wherein he provided his name, social insurance number and details of his infraction. Instead, the court was told, in 2017, that his accountant had made a “no-names” voluntary disclosure. A no-names voluntary disclosure is effectively a way to ask CRA if an infraction has occurred. If the taxpayer never follows up with all of the identifying information CRA needs, the voluntary disclosure is deemed to have never occurred. So, at trial, the court was told that Mr. Colivas was planning to upgrade his no-names voluntary disclosure to the full-fledged version. He just had not gotten around to it yet. Somehow, this was sufficient for the court and Mr. Colivas was allowed the tax deduction for an amount he had not paid in the eight years after the tax breach. Apparently, Mr. Colivas was no Mr. Cosentino.

Given these decisions, one might ask whether the value of a corporation with a history of charging personal expenses as business expenses can be reduced for some likelihood of the tax liability arising. Can a liability be claimed to reduce a valuation or NFP by simply identifying that a wrongdoing had occurred? We have not seen such a decision. Accordingly, if a client wishes to benefit from such a tax reduction in value, a proper voluntary disclosure is likely required. The no-names voluntary disclosure is no longer offered by CRA.

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We are happy to announce that James Savelli has been admitted as a partner at Marmer Penner. James joined Marmer Penner over six years ago after obtaining his CA designation. He became a CBV two years later and has been providing excellent service to our clients throughout this time. James has also completed Level II of his Collaborative Family Law training.

This newsletter is not intended to substitute for proper professional planning. It is intended to highlight areas where professional assistance may be required or enough to discuss at the next hoedown. The professionals at Marmer Penner Inc. will be pleased to assist you with any matters that arise. Please feel free to visit our website at www.marmerpenner.com.