

Colitto Reversed: Section 160 Applies to a Director's Liability in or in Respect of the Year That the Failure Occurs

In *Canada v. Colitto* (2020 FCA 70), the FCA overturned the TCC's decision, and the taxpayer's victory, in *Colitto v. The Queen* (2019 TCC 88). The decisions deal with the interaction of subsection 160(1) and subsections 227.1(1) and (2).

In general terms, subsection 160(1) imposes liability on the recipient of property resulting from certain non-arm's-length property transfers. The amount of the liability is, generally speaking, the difference between the FMV of the property received and the consideration given therefor, except that the liability is limited to the amount of the transferor's total tax debt in or in respect of the taxation year in which the property was transferred or in any preceding taxation year.

Generally, subsection 227.1(1) provides that if, as in this case, a corporation has failed to remit source deductions, the persons who were directors of the corporation at the time that the corporation was required to remit the deductions are jointly and severally liable to pay the amount not remitted plus the related interest and penalties.

However, subsection 227.1(2) provides that a director is not liable under subsection 227.1(1) unless certain conditions are satisfied. One of these conditions (paragraph 227.1(2)(a)) requires that a certificate for the amount of the corporation's liability under subsection 227.1(1) has been registered in the FC under section 223 and that execution for that amount has been returned unsatisfied in whole or in part.

The facts of the case are relatively simple. Domenic Colitto, the respondent's spouse, was a director and shareholder of Core Precision Technologies Ltd. ("Precision"). Precision failed to remit source deductions to the minister between February and August 2008. The parties had agreed that Mr. Colitto had not satisfied the due diligence defence with respect to Precision's failure to remit.

On May 8, 2008, the year in which Precision was in default of its remittance obligations, Mr. Colitto made two transfers of real property to his wife, Caroline Colitto, for nominal consideration (\$2 for each transfer). The value of the first property was \$41,250, and the value of the second was \$187,500.

On October 10, 2008, the minister issued a notice of assessment to Precision for unremitted source deductions, interest, and penalties totalling \$631,554 in respect of which no notice of objection was filed. On August 6, 2009, Precision's tax debt

was registered in the FC under section 223. On November 23, 2010, the sheriff was directed to enforce the writ. On January 4, 2011, Precision's tax debt was executed and returned unsatisfied.

On March 28, 2011, the minister assessed Mr. Colitto in the amount of \$733,813. On January 13, 2016, the minister assessed the respondent under section 160 for \$228,746 in respect of the transfers made by Mr. Colitto. (The amount of the assessment was the maximum amount permitted under section 160.)

At the TCC, the respondent's appeal was allowed on the basis that Mr. Colitto's liability under section 227.1 did not arise until 2011, when Precision's tax debt was executed and returned unsatisfied. Therefore, the court held that the transfers were not caught by section 160 because Mr. Colitto was not liable to pay an amount "in or in respect of" the taxation year in which the properties were transferred. The court reached this conclusion by means of a textual, contextual, and purposive interpretation of subsection 227.1(2), which in the court's view did not impose liability on a director until one of its three conditions of application had been satisfied (in this case, the condition in paragraph 227.1(2)(a)).

The FCA disagreed with the TCC's interpretation of the interaction between section 160 and section 227.1. The FCA conducted its own textual, contextual, and purposive analysis of the relevant statutory provisions; it noted that the only issue in dispute was whether Mr. Colitto's liability under section 227.1 was "in or in respect of" his 2008 taxation year.

The FCA concluded that subsection 227.1(1) was ambiguous regarding the year in which the liability arises. However, the FCA held that any such ambiguity is eliminated when one considers the purpose of subsection 227.1(2). In the FCA's view, the TCC erred in concluding that liability under subsection 227.1(1) did not arise "unless and until" the conditions in subsection 227.1(2) were satisfied. The FCA held that the word "until" was not present in the statute, and the TCC had erred by reading "until" into the statutory language.

In the FCA's view, the purpose of subsection 227.1(2) is the avoidance of double taxation. That is, paragraph 227.1(2)(a) "operates to avoid double taxation by prohibiting the Minister from recovering unremitted source deductions from a director otherwise liable for the deductions if the corporation has already paid all of the liability." The TCC's interpretation of section 227.1 would render the section "nugatory and pointless" by allowing a director to rearrange his or her affairs,

before the relevant conditions were satisfied, to avoid personal financial responsibility. The FCA concluded that Parliament could not have intended this result. Therefore, it held that Mr. Colitto's liability under section 227.1 arose "in or in respect of" his 2008 taxation year and allowed the appeal. That is, for the purposes of applying section 160, Mr. Colitto's liability under section 227.1 arose "in or in respect of" 2008, the year of Precision's failure to remit.

With all due respect to the FCA, we take issue with the reasoning that it relied on in reaching its conclusion. First, it was not necessary for the TCC to insert the word "until" after "unless" in order to regard subsection 227.1(2) as creating a condition for the application of subsection 227.1(1). Merriam-Webster Online defines "unless" to mean "except on the condition that." If something cannot occur "except on the condition that," then arguably it cannot occur until that condition is satisfied.

In addition, the FCA relied on a purposive interpretation to give meaning to the interaction between section 160 and section 227.1. The court identified the avoidance of double taxation as the purpose to which subsection 227.1(2) was directed. However, the language used in the subsection achieves the purported purpose by setting out steps that must be satisfied. Parliament chose to set out the specific steps necessary for the liability to arise. The FCA concluded that the effect of applying section 227.1 as written when one is considering its interaction with section 160 would be to undermine its purpose by allowing a director to intentionally dissipate his or her assets before the steps set out in paragraph 227.1(2)(a) are undertaken. In effect, the FCA has not interpreted the meaning of section 227.1 but rather has interpreted its meaning in connection with the application of section 160.

The purpose of section 227.1 is not defeated by requiring that the conditions in subsection 227.1(2) be satisfied. Rather, the minister's collection powers were defeated by the interaction between section 160 and section 227.1. Parliament chose to use the language "in or in respect of" a taxation year in section 160 because it presumably was of the view that a taxpayer's transfers made during certain times when the taxpayer was not a tax debtor should not attract section 160 liability.

The question is really what purpose is intended when the policy in section 160 interacts with the policy underlying section 227.1. The result of the FCA's interpretation in this case is that even though the minister would not have been able to collect from Mr. Colitto himself in 2008 (because the requirements of subsection 227.1(2) had not yet been satisfied), the minister can retrospectively attack transfers made by Mr. Colitto in that year. It is far from clear to us that this policy result

was intended. Furthermore, in *Canada Trustco Mortgage Co. v. Canada* (2005 SCC 54), the SCC cautioned that "[w]here Parliament has specified precisely what conditions must be satisfied to achieve a particular result, it is reasonable to assume that Parliament intended that taxpayers would rely on such provisions to achieve the result they prescribe."

Sections 227.1 and 160 are draconian provisions that impose one person's tax liability on another. In this case, the language of subsection 227.1(2) was clear and had a precise result. In our view, the proper result would have been for the FCA to simply apply the text as written. It should be left to Parliament to fix the language of sections 160 and 227.1 if it is of the view that its intention has been defeated.

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