TAX NOTES

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CHALLENGES TO CUSTOMS DETERMINATIONS IN CANADA:

Daniel Kiselbach
Vancouver
604.643.1263
dkiselbach@millerthomson.com

This article, the first in a two-part series, outlines several of the rights of appeal relating to customs determinations in Canada.

PART I - CUSTOMS PENALTY CASES

Customs appeals involve the interplay of laws and written and unwritten policies and practices. While rights to commence an appeal are based on statutory provisions, there are few provisions that deal with the appeal process. Further, many of the arguments that might support an appeal may be found in the policies and practices of the Canada Border Services Agency ("CBSA"). Many of these policies and practices are not widely known, are accessible only through an *Access to Information Act* request, or are not reduced to writing. This article will provide an overview of some of the customs appeal rights that exist, and useful strategies in handling an appeal.

Civil Penalties

The nature of the penalties that may be imposed by the CBSA are well known. They include administrative monetary penalties ("AMPS") which can be imposed in relation to activities which occurred in October 2002 and onwards. These penalties are *in personam* penalties, designed to correct the unlawful activities of persons. Second, the Minister has the right to forfeit goods that have been unlawfully imported into Canada. The right of forfeiture is an *in rem* remedy; it is an action taken in relation to unlawfully imported goods. Third, where seizure is not practicable, the Minister may ascertain an amount as forfeit.

The process for appealing of AMPS penalties, forfeitures and ascertained forfeitures is similar. A Notice of Penalty Assessment is issued in relation to AMPS penalties and a Notice of Seizure or Ascertained Forfeiture is issued in relation to forfeitures and ascertained forfeitures.

Civil Penalties - Appeal Rights

AMPS penalties, forfeitures and ascertained forfeitures may be appealed administratively pursuant to section 129 of the *Customs Act*. This is styled as a "request for a decision of the Minister".

The appeal process under section 129 of the *Customs Act* relates to instances where a penalty has been issued under the AMPS program or goods have been seized or ascertained as forfeit from any party *having possession of the goods*. Where goods are seized as forfeit, persons other than the person in whose

Inside

possession the goods were when seized or detained or ascertained as forfeit may claim an interest *as an owner*. These types of appeals are known as "third party claims". Third party claims may be made by requesting a decision of the Minister pursuant to section 139 of the *Customs Act*.

Civil Penalties - Appeal Process

While the *Customs Act* provides a right to request a decision of the Minister in respect of the issuance of a penalty, the *Customs Act* is silent on the appeal process. As a general rule, administrative decision makers are the masters of their own processes. This means that the process of an appeal can be negotiated to conform with the legal principles of natural justice and fairness. At a minimum, appeals officers have a duty to act fairly, and to hear both sides of the case.

While principles of administrative fairness and natural justice are well recognized, courts have not frequently applied these principles in the context of customs appeals. As a practical matter, there are typical steps that may be taken by counsel in connection with a customs appeal to ensure that a matter is fairly determined.

First, a notice of appeal should be issued setting out the nature of the appeal and requesting all relevant documents and policies. Typically, a notice of appeal will contain a request for such information as the CBSA investigator's narrative report and supporting notes, memoranda, documents and policies. For example, the CBSA Enforcement Manual contains policies on such matters as the meaning of words such as "undervaluation", "misdescription" and "false statement". The Enforcement Manual also sets out a protocol for questioning traders and travellers and examining persons, goods or conveyances at a port of entry.

Second, to ensure full disclosure takes place, it is common to make an application pursuant to the *Access to Information Act* for all relevant records. CBSA officers are obliged to disclose all non-confidential or non-privileged information as defined under the *Access to Information Act*. The improper withholding of relevant documents can be appealed to the *Access to Information Act* Commissioner, and ultimately to the Federal Court. Disclosure may be more complete under the *Access to Information Act* process than would be obtained voluntarily. An *Access to Information Act* request should be considered in circumstances such as:

(a) where there are grounds to believe that an undisclosed policy directive exists; or

(b) where the credibility of the CBSA officer or of the person concerned is in issue.

Third, in respect of evidence, a narrative report is usually provided by the investigator. The narrative report is typically not under oath or affirmation. An adjudicator who determines the appeal may prefer the sworn affidavit evidence of an importer on key issues if an affidavit is provided.

Fourth, it is open to the appellant to attack the reliability or credibility of the evidence of CBSA officer (usually provided in the form of a narrative report). The supporting materials put forward by the CBSA (such as reports from other agencies) can also be impugned if they lack credibility or reliability. For example, CBSA investigators may rely upon a summary of evidence provided by a foreign governmental source such as a foreign police agency. The foreign police source summary may include statements from informers. This type of evidence may be impugned on the grounds that it is "totem-pole hearsay" (that is, hearsay upon hearsay) and lacks the criteria of reliability or necessity.

Finally, it is usually desirable to state the appellant's case in the form of written submissions. The best practice is to concentrate on the central issues either to convince the appeals officer that no infraction occurred, or that the penalty was unwarranted or disproportionate having regard to mitigating factors.

Civil Penalties - Mitigating Factors

Possible mitigating factors include the exercise of all reasonable care/due diligence. Components of a due diligence defence may include the following:

(a) following industry standards (to ensure that systematic computerized processes are followed for the tracking and storage of key customs documents);

(b) training employees with respect to customs procedures;

(c) implementation of manual procedure outlining the procedures to be followed and the issues to be addressed (e.g., valuation classification origin marking, provincial sales tax or GST); and

(d) following opinions with respect to customs issues as necessary (e.g., valuation, classification, origin marking, provincial sales tax or GST).

Other mitigating factors include lack of intent to deceive, lack of experience in importing, Act of God/force majeure, computer breakdowns, reliance upon official statements and reliance upon opinions provided by customs advisers.

Customs appeals are typically dealt with on the basis of paper submissions. However, it is absolutely critical in some cases to have an opportunity to discuss the case with the CBSA appeals officer. In some cases, it is also useful to have an officer or employee of the appellant company be present to show that the company is serious about compliance and to answer any questions arising in connection with the appeal.

Once submissions are made, it is also useful to request that the appeals officer provide an opportunity to respond to disabuse the officer of any concerns that he or she may have regarding the merits of the case, make supplemental submissions regarding any concerns at a later date.

AMENDMENTS TO CPP AND EI LEGISLATION: POSSIBLE REFUNDS FOR BUSINESS ACQUISITIONS AFTER 2003

Steven McLeod
Toronto
416.595.7906
smcleod@millerthomson.com

Recent amendments to the *Employment Insurance Act* and the *Canada Pension Plan* offer the possibility of a premium refund to a purchaser of a business who becomes a successor employer during a year. This is relevant for both arm's length asset sales and internal non-arm's length re-organizations which occurred after 2003.

THE OLD RULES

The old rules under the CPP and EI legislation gave the federal government a windfall when a purchaser of a business became a successor employer mid-year in that the successor employer received no credit for CPP and EI premium contributions made by the predecessor employer earlier in the year. Accordingly, the federal government in these circumstances would receive more than the maximum annual employer contributions for CPP and EI purposes.

THE NEW RULES

Amendments to the CPP and EI legislation came into force, respectively, May 14, 2004 and January 31, 2005, to allow the purchaser of a business to take into account the premiums paid in the year by the former employer when determining its CPP and EI obligations for the year in which the transfer occurred. The amendments are effective for transactions taking place after 2003.

The following example illustrates the application of the amendments in the case of employer CPP obligations. In 2004, the maximum employer and employee contribution to the CPP were each $1,831.50. Under the old rules, if Acme Riveting Inc. paid $500.00 of employer CPP premiums in respect of its employee, Rosie the Riveter, in 2004 and then in 2004 sold its assets and transferred its employees, including Rosie, to Canada Riveting Ltd., Canada Riveting Ltd. would receive no credit for Acme's contribution and would therefore potentially have to pay the maximum of $1,831.50 in employer CPP premiums in respect of Rosie for 2004. Under the new rules, Canada Riveting Ltd. would only have to pay up to $1,331.50 in CPP premiums for 2004. If there were numerous employees transferring, the result in savings could be substantial.

IMPLICATIONS AND REFUND

1. To secure the benefit of the new rules, when employees are transferred during a year as part of an asset sale, or a reorganization within a corporate group, the asset purchase agreement should require the vendor to provide particulars of the vendor's CPP and EI contributions for the year. Knowing the former employer's contributions will allow the reduction of the successor employer's CPP and EI obligations accordingly.

2. In the case of any sales of businesses (both arm's length and internal) since January 1, 2004, where a purchaser was a successor employer and made CPP and EI contributions under the old rules, it would be eligible for a refund. As noted above, the refund would be the amount by which the EI and CPP contributions of both the former and successor employer in the year exceeds the maximum employer contribution limit set out in the EI and CPP legislation.

- Applications for refunds of CPP must be made within 4 years of year end.
- Applications for refunds of EI must be made within 3 years of year end.

LIFTING THE CORPORATE VEIL FOR LAND TRANSFER TAX

Douglas Han
Toronto
416.595.2653
dhan@millerthomson.com

The recent decision of the Divisional Court of the Ontario Superior Court of Justice in *Upper Valley Dodge Chrysler Limited v. The Minister of Finance* shows how policy-based arguments can be successful in dealing with tax disputes in the courts. This case involved the transfer of real estate (the "Property") directly by the sole shareholder and officer to the appellant corporation.

WM, a natural person, legally and beneficially owned the Property which was registered in his name. WM was also the sole shareholder and officer of Upper Valley Dodge Chrysler Limited (the "Corporation"). The Corporation operated a motor vehicle dealership on the Property prior to December 28, 1994. On December 28, 1994, WM conveyed the Property to the Corporation and claimed the exemption from Ontario Land Transfer Tax ("LTT") for transfers to family business corporations, provided for in s.3 of *Ontario Regulation 697*.

The Corporation was assessed for LTT on the basis that it did not meet the exempting requirements in the Regulation. The particular exempting Regulation requires, *inter alia*, that the transfer be a "conveyance of land from an individual … to a family business corporation provided that, … (a) prior to such conveyance the land was used predominantly in the operation of an active business which was operated exclusively by an individual …"

The issue in respect of the appeal to the Divisional Court was whether the term "individual" for the purpose of paragraph 3(1)(a) of the Regulations could include a corporation.

Surprisingly, the majority of Court upheld the decision of the trial court that the Corporation fell within the meaning of the term "individual" for the purpose of this particular Regulation. The Court upheld the analysis of the trial court that WM was an "operator" of the business as a sole shareholder and officer of the Corporation. The majority of the Court appeared to confuse whether WM or the Corporation was required to "operate" the active business in the Regulation. The Court also referred other statutes and case law in which corporations were held to fall within the meaning of "individual". It should be noted that Matlow J disagreed with the analysis of the majority in a strong and logical dissent.

The consequences in this decision are likely limited to this particular fact situation. It is unlikely that the extension of the definition of individual to include the Corporation would apply for other taxing legislation. The Court's reasoning is subject to challenge and the decision is under appeal to the Ontario Court of Appeal. It is likely that subsequent cases would be distinguished on their facts to narrow the application of this decision.

Nevertheless, the lesson to be learned from this case is that policy arguments can be effective in court when it appears that taxes have been levied in unreasonable circumstances. In this particular case, it is reasonable that a natural person who owns land on which a family business operates should be able to transfer the land to the corporation that operates the business. It would seem unfair to tax a natural person who transfers land to his family business corporation at a date later than when the business assets are transferred but not tax a natural person who simultaneously transfers land and other business assets to such a corporation. There would appear to be no good policy reason to make such a distinction. Although this policy issue is not specifically addressed in the case, it is not surprising that the Court found an interpretation which overcame such an unreasonable policy distinction in the *Land Transfer Tax Act*.

Across Canada, provincial taxing legislation is often vague and subject to varying interpretations based on the perceived intention of the legislation. This decision of the Court is further evidence of why appeals of unreasonable positions by tax authorities can be often successful.

WHAT'S HAPPENING AROUND MILLER THOMSON LLP

Joseph W. Yurkovich of our Edmonton office presented a paper entitled *Bill 16 Amendments to the ABCA* at the CBA Northern Alberta Business Law Section in March, 2005.

Robert B. Hayhoe of our Toronto office published an article entitled *Update on Canadian Charities Operating Abroad* in the Exempt Organization Tax Review in June, 2005.

Susan M. Manwaring of our Toronto office published an article entitled *The Donor Advised Fund - An Option for Philanthropy in Canada* in the STEP INSIDE Summer Issue, 2005.

Daniel L. Kiselbach of our Vancouver office will be presenting a paper entitled *Minimizing Duties, GST and Taxes on Imports* in Seattle in August, 2005.

Robert B. Hayhoe will be speaking on *Canadians and Americans Working Together* at the IFMA General Meeting in Minneapolis on September 22 - 24, 2005.

Robert B. Hayhoe will be presenting a paper with Lisa Mellon of World Vision Canada entitled *Carrying Out Agency Agreements in the Field* at the Canadian Council of Christian Charities Annual Conference in Toronto on September 28, 2005.

Robert B. Hayhoe will be a panel moderator on *The Place of Religion in Society* at the Christian Legal Fellowship and Canadian Council of Christian Charities Joint Day Symposium in Toronto on September 29, 2005.

Daniel L. Kiselbach will be presenting a paper entitled *Minimizing Duties, GST and Taxes on Imports* in Boston on September, 2005.

John M. Campbell of our Toronto office will be co-presenting a case study on *Safe Income* at the Canadian Tax Foundation Conference in Toronto on October 17, 2005.

Martin J. Rochwerg of our Toronto office will be chairing the *Tax and Estate Planning for Entrepreneurs and Owner-Managers'* sessions for the Ontario Tax Conference of the Canadian Tax Foundation in Toronto on October 17 and 18, 2005.

Martin J. Rochwerg will be co-presenting with Barbara Hauser of Cadwallader a paper on *Cross-border Tax* at the Senior Trusts and Estates Forum in Toronto on October 21, 2005.

Robert B. Hayhoe will be presenting a paper entitled *Gifts to Avoid* at the Canadian Association of Gift Planners Meeting in Toronto on October, 2005.

Daniel L. Kiselbach will be presenting a paper entitled *Minimizing Duties, GST and Taxes on Imports* at the IE Canada Annual General Meeting in Toronto on October, 2005.

Rachel Blumenfeld of our Toronto office will be speaking with Jeffrey C. Carhart of Miller Thomson LLP on *Insolvencies and Corporate-owned Life Insurance, Tips and Traps* at the Conference of Advanced Life Underwriters in Toronto on November 4, 2005.

Normand Royal of our Montreal office will be lecturing on *Income Tax Features of Limited Partnership Agreements* at the Income Tax Features of Commercial Agreements Seminar of the Canadian Institute in Montreal on November 14, 2005.

John M. Campbell will be speaking on *Recent Caselaw* at the Canadian Institute of Chartered Accountants National Conference in Toronto on November 21 - 22, 2005.

Daniel L. Kiselbach will be presenting and publishing a paper entitled *Minimizing Duties, GST and Taxes on Imports* for the Western Chapter of the Canadian Tax Foundation in October, 2005.

MILLER THOMSON LLP TAX GROUP

Toronto/Markham

Rachel L. Blumenfeld	416.596.2105
John M. Campbell	416.595.8548
Arthur B.C. Drache, Q.C., C.M.	416.595.8681
Gerald D. Courage	416.595.8163
Douglas Y. Han	416.595.2653
Robert B. Hayhoe	416.595.8174
James A. Hutchinson	416.597.4381
Susan M. Manwaring	416.595.8583
Steven McLeod	416.595.7906
Martin J. Rochwerg	416.596.2116

Vancouver

Mark P. Chartrand	604.643.1232
Robert MacRae	604.643.1265
Katherine Xilinas	604.643.1233

Calgary

Clarke D. Barnes	403.298.2402
Natalie Fenez	403.298.2425
William J. Fowlis	403.298.2413
Sandra M. Mah	403.298.2466
Gregory P. Shannon	403.298.2482

Edmonton

Wendi P. Crowe	780.429.9764
Joseph W. Yurkovich	780.429.9716

Waterloo-Wellington

Stephen R. Cameron	519.579.3660

Montréal

Richard Fontaine	514.871.5496
Bertrand Leduc	514.871.5451
Normand Royal	514.871.5453
Lysane Tougas	514.871.5487

MILLER THOMSON LLP CUSTOMS AND TRADE LAWYER

Daniel L. Kiselbach	604.643.1263