

## Section 160 and Transfers Between Spouses: Distinguishing Moral from Legal Obligations

In *Brown v. The Queen* (2020 TCC 45), the TCC considered whether transfers made by Mr. Levoy to his spouse, Ms. Brown, were given for valid consideration or were made merely in respect of non-enforceable moral obligations, and consequently whether such transfers triggered the application of section 160.

The facts were relatively simple. Ms. Brown received notices of assessment dated September 17, 2010 in respect of transfers made to her by Mr. Levoy in 2006, 2007, and 2008 in the amounts of \$98,063, \$51,776, and \$3,348, respectively. At the time of the transfers, Mr. Levoy owed tax in amounts far exceeding the amounts transferred to Ms. Brown. Mr. Levoy's tax debts were the result of an unfortunate set of personal circumstances arising from his ownership (through a corporation) and management of a resort in Ontario. A call centre at the resort was rented out to a third party, which used it to conduct criminal activities. Mr. Levoy, who was unaware of the criminal activities, was criminally charged in Canada in 2002, and subsequently in the United States.

An external audit firm performed an audit on the operations of the resort in the wake of the criminal charges. On the audit firm's advice, Mr. Levoy made a voluntary disclosure

to the CRA in 2002 for taxes owing that related to preceding taxation years. In 2006, the CRA informed Mr. Levoy that his voluntary disclosure had not been accepted.

As a result of the ongoing criminal charges, all of Mr. Levoy's bank accounts were shut down. Even after the criminal charges in the United States and Canada were dropped in 2004 and 2005, Mr. Levoy remained unable to open a new bank account.

In 2005, to improve the operation of the resort, an external provider was hired to handle payroll responsibilities at the resort. Mr. Levoy opted to receive his salary by cheque rather than direct deposit because he did not have a bank account. However, Mr. Levoy's accountant suggested that Ms. Brown deposit the salary cheques into her bank account and then pay Mr. Levoy's monthly credit card charges. Despite her initial reluctance, Ms. Brown agreed to this arrangement.

Ms. Brown maintained accounting records in respect of the relevant transfers and credit card payments, as did Mr. Levoy. If Mr. Levoy's deposits exceeded his credit card bill for a month, Ms. Brown would roll over the excess deposits and apply them to the credit card bills in subsequent periods.

As a result of his financial difficulties, Mr. Levoy made a proposal in bankruptcy that was accepted by his creditors; the proposal included payments to the CRA of \$171,300. As of July 2016, Mr. Levoy was no longer in debt to the CRA.

Two questions were before the TCC: (1) Had Ms. Brown given adequate consideration pursuant to paragraph 160(1)(e) such that the impugned transfers did not attract the application of section 160? (2) What was the effect of the subsequent successful bankruptcy proposal on the impugned transfers?

With respect to the first question, since three of the four elements of the test set out in *Canada v. Livingston* (2008 FCA 89) (which is a judicial restatement of the statutory applicability of section 160) were satisfied, the only question for the court to consider was the fourth element—namely, whether Ms. Brown had given adequate consideration to Mr. Levoy in respect of the transfers made by him to her.

The Crown cited *Livingston, Raphael v. Canada* (2002 FCA 23), and *Pickard v. The Queen* (2010 TCC 535) in support of the assertion that Ms. Brown's obligation was moral and not legal, and argued that section 160 therefore applied in respect of the relevant transfers. However, the court distinguished the present case from the cases cited by the Crown. The court held that there was an enforceable contract between Mr. Levoy and Ms. Brown pursuant to which Ms. Brown undertook to deposit Mr. Levoy's paycheques in her personal bank account and in return committed to pay Mr. Levoy's credit card bills pursuant to his direction. The evidence showed that had Ms. Brown failed to discharge this obligation, Mr. Levoy could have sued

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her to enforce the action. Thus, the obligation was a legal and not a moral one.

The TCC noted that in *Livingston* (where the court had reached a different result in similar circumstances), an intention to defraud the CRA was present. Such an intention was not a requirement to satisfy section 160, but it was a factor that the FCA in *Livingston* considered when assessing the adequacy of the consideration. The TCC distinguished the present case from *Livingston* on the basis that, among other reasons, no intention to thwart the collection efforts of the CRA was present because Ms. Brown had agreed to the arrangement with Mr. Levoy before the failure of his voluntary disclosure and while she was unaware that Mr. Levoy was a tax debtor. The court also distinguished the present case from *Pickard* for a number of reasons, including *Pickard's* lack of corroborating testimony and accounting evidence, which Ms. Brown was able to furnish in the present case.

On the basis that there was a legally enforceable agreement in place between Ms. Brown and Mr. Levoy, the TCC held that subsection 160(1) did not apply to the impugned transfers, and it allowed the appeal. Because this holding rendered the effect of the bankruptcy proposal moot, the court declined to consider that question.

This case serves as a practical warning to tax practitioners regarding transfers between spouses. To the extent that it is intended that a transfer between spouses not attract the application of section 160 because the spouse accepting the transfer will give full consideration in the form of assuming a corresponding obligation to pay the expenses of the transferring spouse, that intention should be reinforced with written documentation. Appropriate documentary evidence, supplemented by accounting showing that the obligation was properly discharged, will reduce the likelihood that any such transfers will be impugned under section 160.

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