

TAXPAYER RELIEF APPLICATIONS - PART I

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm regarding taxpayer relief applications to the CRA and applications to the Federal Court for judicial review of taxpayer relief decisions by the CRA. Alpert Law Firm is experienced in providing legal services to its clients in tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions and estate administration.

A. THE TAXPAYER RELIEF PROVISIONS

As of May 31, 2007, the Canada Revenue Agency (the “CRA”) replaced the “fairness provisions” with the “taxpayer relief provisions”. The taxpayer relief provisions contained in the *Income Tax Act* (the “Act”) give the CRA wide discretion to give equitable relief to taxpayers in order to: (i) cancel and waive penalties and interest; (ii) accept late-filed, amended, or revoked income tax elections; or (iii) issue income tax refunds beyond the normal three-year period to individuals and testamentary trusts. Most typically, taxpayer relief applications request the CRA to waive interest and penalties, occurring as a result of either: (i) processing delays by the CRA; or (ii) financial hardship on the part of the taxpayer.

For any fairness requests and income tax returns filed on or after January 1, 2005, a taxpayer has ten years from the end of the calendar year in which the taxation year or fiscal period in issue ended in order to make an application for relief. Unless an initial request or income tax return was filed before the ten-year limitation rule came into effect on January 1, 2005, requests filed for the 1985 to 1994 tax years will not be accepted and refunds beyond the normal three-year period will not be issued. If an assessment or reassessment for a taxation year is issued by the CRA in a later year, or if an objection or appeal filed by the taxpayer may take considerable time to resolve, the taxpayer should submit the request for any potential relief before the expiry of the ten-year time limit for that taxation year.

The Federal Court of Appeal considered this limitation period in **Bozzer v. Minister of National Revenue**, 2011 FCA 186, and determined that the Minister may exercise its discretion to cancel interest that accrued in any taxation year ending within ten years before the taxpayer’s application for relief, regardless of when the underlying debt arose. Therefore, if a taxpayer makes an application on January 1, 2013, the Minister may not cancel a penalty imposed on January 1, 2002, but the Minister is nonetheless permitted to cancel interest that accrued on that penalty in 2003 and all subsequent taxation years.

The CRA has published Information Circular 07-1 ("IC 07-1"), entitled "Taxpayer Relief Provisions", which outlines: (i) the guidelines for the cancellation or waiver of penalties and interest; (ii) the guidelines for accepting late, amended, or revoked elections; (iii) the guidelines for refunds or reduction in amounts payable beyond the normal three-year period; and (iv) the rules and procedures for when relief will be granted.

B. CIRCUMSTANCES IN WHICH PENALTIES AND INTEREST MAY BE CANCELLED OR WAIVED

Subsection 220(3.1) of the Act permits the Minister to waive or cancel all or any part of a penalty or interest otherwise payable under the Act by a taxpayer or a partnership. As a general rule, the Minister will grant relief only where the default giving rise to the penalty or interest in question is due to extraordinary circumstances beyond the applicant's control, such as:

- (i) natural or human-made disasters, such as a flood or fire;
- (ii) civil disturbances or disruptions in services, such as a strike;
- (iii) serious illness or accident, or serious emotional or mental distress, such as death in the immediate family;
- (iv) erroneous information from the CRA in the form of incorrect written answers or errors in published information;
- (v) delays by the CRA in processing or providing necessary information;
- (vi) when collection has been suspended because of an inability to pay caused by the loss of employment and the taxpayer is experiencing financial hardship; or
- (vii) when a taxpayer is unable to conclude a reasonable payment arrangement because the interest charges absorb a significant portion of the payments.

C. CIRCUMSTANCES IN WHICH CERTAIN LATE, AMENDED OR REVOKED ELECTIONS MAY BE ACCEPTED

Subsection 220(3.2) of the Act permits any taxpayer or partnership to apply to the Minister to make a late election, or to amend, or revoke a previous election. In order to obtain an extension of time for making an election, the taxpayer or partnership must generally demonstrate that:

- (i) the taxpayer took reasonable steps to comply with the Act, even though unintended tax consequences resulted;
- (ii) the election was not filed on time due to the same types of extraordinary circumstances beyond the applicant's control which are set out in section B above;
- (iii) the taxpayer relied on incorrect information received from the CRA;
- (iv) the request results from a mechanical error;
- (v) the later accounting of the transactions by the taxpayer was as if the election was made or had been made in a particular manner; or
- (vi) the taxpayer was unaware of the availability of the election.

With respect to applications to amend or revoke a previous election, IC 07-1 suggests that the taxpayer or partnership must demonstrate that the original election would cause an unintended tax result.

D. CIRCUMSTANCES IN WHICH REFUNDS MAY BE ISSUED BEYOND THE NORMAL THREE-YEAR PERIOD

Subsection 152(4.2) of the Act allows the Minister discretion to reassess or re-determine beyond the normal three-year reassessment period for a taxpayer (who is an individual or a graduated rate estate), in order to give that taxpayer a refund or to reduce taxes payable for the taxation year in question. The reassessment or re-determination will generally be made where the Minister is satisfied that: (i) the request would have been honoured had it been made within the normal reassessment period; (ii) the necessary adjustment is correct in law; and (iii) the request was not previously allowed.

E. SECOND LEVEL OF REVIEW BY THE CRA

Where the CRA issued a decision not to grant the taxpayer relief requested, the Act provides that the taxpayer can request a second level of review to be performed by

the CRA. This second level of review is made by the Director of the relevant district office or taxation centre. If taxpayer relief is refused as a result of a second level of review, an unsatisfied applicant may apply to the Federal Court for judicial review of the taxpayer relief decision made by the CRA.

F. JUDICIAL REVIEW OF A TAXPAYER RELIEF DECISION

The taxpayer may apply to the Federal Court for judicial review of a taxpayer relief decision made by the CRA within thirty days of the date the decision was communicated to the taxpayer, if the taxpayer feels that the CRA did not properly exercise its discretion during the review of the request for relief. The judicial review by the Federal Court is restricted to determining whether the CRA exercised its discretion in a fair and reasonable manner. The Federal Court will not overturn a decision made by the CRA. However, in the event that the Federal Court rules that the CRA did not exercise its discretion in a fair and reasonable manner, it will refer the matter back to the CRA for reconsideration of the taxpayer relief application based upon the criteria set out by the Federal Court.

G. RECENT CASE LAW

(I) STANDARD OF JUDICIAL REVIEW

1. Lanno v. Canada Customs and Revenue Agency, 2005 DTC 5245

In this Federal Court of Appeal decision, the taxpayer applied for fairness relief on the basis that his failure to file timely notices of objection was the result of a number of misunderstandings with his tax representative. The CRA denied the taxpayer's fairness application. The taxpayer appealed for judicial review of the Minister's fairness decision to the Federal Court of Appeal.

The Federal Court of Appeal allowed the taxpayer's appeal. The Federal Court of Appeal found that the trial judge had applied the wrong standard to the decision under review. The Federal Court of Appeal held that the correct standard of review, in this case, was reasonableness. The Federal Court of Appeal also held that the Minister's review was unreasonable on the grounds that the Minister: (i) misapprehended the relevant facts; and (ii) failed to address the question as to why the taxpayer had been treated differently from other investors in the real estate project who obtained favourable reassessments from the Minister in exactly the same circumstances. The matter was referred back to the Minister for re-determination by a different decision-maker.

(I) **ERRORS IN THE TAXPAYER RELIEF DECISION OR THE TAXPAYER RELIEF REPORT**

1. **Bremer v. Attorney General of Canada, 2006 DTC 6125**

In this Federal Court of Canada decision, the Minister refused to grant relief from the interest and penalty charges resulting from the late filing of the taxpayer's 2002 tax return. In the Minister's view, there was no extraordinary circumstance preventing the taxpayer from filing his 2002 return on time and the taxpayer had a history of non-compliance with his tax obligations. The taxpayer applied to the Federal Court for judicial review of the Minister's decision.

The Federal Court held that the fairness decision made by the CRA was unreasonable and granted the application for judicial review. The Federal Court held that in reaching the fairness decision, the CRA decision-maker made a reviewable error by assuming that, at the time when the taxpayer filed his tax return, there was still tax owing. In reality, after discovering that he owed tax, the taxpayer made a payment in May 2003, which eliminated the entire balance of outstanding tax. However, the taxpayer did not file his tax return until October 2003. The Federal Court held that in the circumstances, it was impossible to determine what the fairness decision would have been, had the decision-maker not made this error. Therefore, the Federal Court referred the matter back for reconsideration by a different decision-maker.

2. **Finanders v. Attorney General of Canada, 2015 FC 448**

In this Federal Court of Canada case, the taxpayer went on short term disability in June 2008 due to surgeries for carpal tunnel syndrome. She filed her 2008 income tax return based on the T4 slip including short term disability payments issued by her employer. As a result of surgical complications, the taxpayer went on long term disability in 2009. She failed to include the long term disability payments in her 2009 tax return because she had been told by her long term disability manager that the payments were not taxable. In addition, she did not receive her 2009 T4 slip including the long term disability payments because it was sent to her former address. CRA assessed a penalty and interest as a result of the omission. The taxpayer withdrew RRSP funds to remit some of her outstanding tax liability, causing her hardship due to increased taxable income and loss of eligibility for tax credits. The taxpayer applied for taxpayer relief to waive the penalty and interest for the 2009 taxation year on the basis of financial hardship and other extraordinary circumstances. The taxpayer's request for relief was partially granted. CRA allowed the cancellation of interest, but refused to waive the penalty. The taxpayer applied to the Federal Court of Canada for a judicial review of the CRA decision

The Federal Court of Canada allowed the taxpayer's application for judicial review on the ground that the CRA decision maker made his decision based on an erroneous finding of fact. In the CRA decision letter, one of the reasons provided for its refusal to waive the penalty was that the taxpayer had correctly reported long term disability benefits in her 2008 income tax return; therefore, the CRA determined that she should have also known to report the long term disability benefits in her 2009 return. The taxpayer was in fact on short term disability in 2008, rather than on long term disability as stated in the CRA decision letter.

The Federal Court decided based on the evidentiary record that it was not unreasonable for the taxpayer to believe that short term disability payments were taxable, while long term disability payments were not. The Federal Court held that because it is impossible to tell whether the result would have been different had the CRA decision maker considered the actual facts, the decision was unreasonable and the matter must be remitted to another decision maker for redetermination.

(III) FINANCIAL HARDSHIP

1. **LaFramboise v. Canada Revenue Agency, 2008 DTC 6178**

In this Federal Court of Canada decision, the taxpayer was assessed interest and penalties for not filing his income tax returns when required and for failing to include all his income. He applied for a waiver of interest and penalties on the following two grounds: (i) a fire had destroyed his house, forcing him to live elsewhere and throwing his life into disarray; and (ii) he could not afford to pay the interest and penalties, based on his current income level and future prospects. The Minister denied both his first and second request for relief. The taxpayer applied to the Federal Court for judicial review of the Minister's decision.

The Federal Court allowed the application for judicial review. In reviewing the decision, the Federal Court found little evidence that the CRA officials attempted to understand how the house fire affected the taxpayer's life and income tax obligations. The record did not indicate that consideration was given to whether the house fire prevented the taxpayer from exercising a reasonable amount of care in conducting his affairs under the self-assessment system.

The Federal Court also considered the taxpayer's ability to repay his tax obligations, noting that while the taxpayer had \$60,000 equity in his home, he could not obtain refinancing on his home due to his low income. Moreover, if he sold his home to retire his tax debt, interest, and penalties, he would be left with little money and no place to live. The Federal Court concluded that the CRA officials did not give due consideration

to these consequences. Therefore, the Court quashed the Minister's decision and referred the matter back to a different delegate of the Minister for redetermination.

2. Quastel v. Canada Revenue Agency, 2011 FC 143

In this Federal Court of Canada decision, the taxpayers, a husband and wife, were assessed gross negligence and late filing penalties for their 1999, 2000 and 2001 taxation years. These assessments were made using a bank deposit analysis method. On consent, the Tax Court of Canada vacated the gross negligence penalties and settled the amounts of taxable income for those taxation years. The taxpayers applied for a waiver of interest and late-filing penalties pursuant to subsection 220(3.1) of the Act. They requested the waiver on the basis of financial hardship, stating that they were expecting another child, and that the husband had been ill in 1999 and had required treatment in Israel. They also denounced the "bullying of collections personnel and glacial inefficiency at CRA" and alleged that the interest accrued as a result of the CRA's inefficiency.

The Minister's decision-maker denied both the first and second requests for relief, noting that there was no evidence that treatment of their file by the CRA was exceptionally long or that delays were attributable to the CRA. The decision-maker determined that the husband's illness was not reasonably linked to the late filing of returns, and that the taxpayers did not have a history of compliance with their tax obligations. Finally, the decision-maker noted that financial hardship means a prolonged inability to provide the basic necessities of life. The taxpayers had not experienced such hardship, as they were able to purchase a house in 2001 while allowing their tax account to remain unpaid.

The Federal Court dismissed the taxpayers' application for judicial review, determining that the Minister's decision was reasonable. The taxpayers had not brought forward all relevant documentation, which required the CRA to prompt them on some occasions. This contributed to the delay in the progress of their case. In addition, the Minister assessed the taxpayers' financial situation objectively in comparison with poverty guidelines, which was reasonable. The Federal Court held that there was no breach of procedural fairness, and that the Minister had assessed all relevant evidence and made a reasonable conclusion.

(IV) MISAPPLICATION BY THE CRA OF THE ACT OR THE TAXPAYER RELIEF GUIDELINES

1. 3500772 Canada Inc. v. Canada, 2008 DTC 6396

In this Federal Court of Canada decision, the taxpayer was a holding company whose sole business was to hold shares in a particular Canadian corporation ("CPET").

In 1999, the taxpayer sold a number of shares of CPET, with the intention of paying the taxes owing from the sale by selling additional shares. The value of the shares fell, and the taxpayer was not able to liquidate the shares and pay its tax liability on time. The taxpayer applied for fairness relief, requesting that the arrears interest be waived on the basis that the tax liability was incurred due to circumstances beyond the taxpayer's control. The Minister refused the taxpayer's first and second relief application. The taxpayer then applied to the Federal Court for judicial review.

The Federal Court allowed the taxpayer's application for judicial review. The Federal Court found that the Minister misinterpreted the Guidelines in Information Circular 92-2 by requiring that the circumstances beyond a taxpayer's control be "extraordinary circumstances." It held that the Guidelines did not require the circumstances to be both beyond a taxpayer's control and extraordinary, and that extraordinary circumstances were merely examples of circumstances that are beyond a taxpayer's control. The Federal Court also held that certain findings of fact were erroneous and made without regard to the material on record. The matter was referred back to the Minister.

Information Circular 92-2 was cancelled on May 31, 2007 and replaced with IC 07-1.

2. Spence v. The Queen, 2010 DTC 5024

In this Federal Court of Canada decision, the taxpayer worked for various employers. In February 2007, the taxpayer went to H&R Block to have his tax return prepared; however, H&R Block failed to include the taxpayer's income from two employment sources. As a consequence, the taxpayer's total income was under-reported. This mistake was caught by the Minister in April 2008 when they assessed the taxpayer for omission penalties and arrears in interest. In August 2008, H&R Block applied to the Minister for taxpayer relief on behalf of the taxpayer, on the basis that the taxpayer was unaware of the omission of income and that the penalties were excessive in the circumstances.

At the first level fairness review, the ministerial representative denied the request, stating in part that the "CRA is not responsible for third party errors and omissions". At the second level fairness review process, the ministerial representative stated that the penalty was harsh, but she did not recommend cancelling the penalties as there were no extraordinary circumstances. The ministerial representative's position was that she was bound by the Fairness Guidelines, and that the statutory fairness provisions precluded her from granting relief in these types of situations. The taxpayer applied to the Federal Court for judicial review.

The Federal Court allowed the application for judicial review, stating that: (i) the appropriate standard was reasonableness; and (ii) the ministerial representative had made an error. The Federal Court held that the law does not permit the decision-maker to treat the Guidelines as binding upon the individual requesting relief. Thus, the ministerial representative erred when she stated that the taxpayer relief provisions *did not allow* for the cancellation of penalties and interests in these situations. Furthermore, in determining whether exceptional circumstances exist, decision-makers should not limit what will be excepted as an exceptional circumstance to things listed in the Guidelines.

This issue of the Legal Business Report is designed to provide information of a general nature only and is not intended to provide professional legal advice. The information contained in this Legal Business Report should not be acted upon without further consultation with professional advisers.

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