

## **JUDICIAL REVIEW OF CRA TAXPAYER RELIEF DECISIONS**

**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 "ITA") give the CRA wide discretion to give equitable relief to taxpayers in order to: (1) cancel and waive penalties and interest; (2) accept late-filed, amended, or revoked income tax elections; or (3) 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. Since 2004, an application must be made within ten years of the end of the taxation year to which the relief relates.

The CRA has published Information Circular 07-1, entitled "Taxpayer Relief Provisions" which outlines the guidelines for the cancellation or waiver of penalties and interest, the guidelines for accepting late, amended, or revoked elections, the guidelines for refunds or reduction in amounts payable beyond the normal three-year period and 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 ITA permits the Minister to waive or cancel all or any part of a penalty or interest otherwise payable under the ITA 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:

- natural or human made disasters, such as a flood or fire;
- civil disturbances or disruptions in services, such as a strike;

- serious illness or accident, or serious emotional or mental distress, such as death in the immediate family;
- erroneous information from the CRA in the form of incorrect written answers or errors in published information;
- delays by the CRA in processing or providing necessary information;
- 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
- 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 ITA permits any taxpayer or a 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 the partnership must generally demonstrate that:

- (i) the taxpayer took reasonable steps to comply with the ITA, however, 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 taxpayer is as if the election was made; and
- (vi) the taxpayer was unaware of the availability of the election.

With respect to applications to amend or revoke a previous election, Information Circular 07-1 suggests that the taxpayer or the 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 ITA 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 testamentary trust), 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 the request would have been honoured had it been made within the normal reassessment period and the necessary adjustment is correct in law and 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 ITA 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. In the event that taxpayer relief is refused as a result of a second level of review, then 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, 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 reasonable and fair 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 reasonable and fair 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**

The taxpayer applied for fairness relief on the basis that his failure to file timely notices of objection had resulted from 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 held that the Minister's review was unreasonable on the following 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 had obtained favourable reassessments from the Minister in exact same circumstances. The matter was referred back to the Minister for re-determination by a different decision-maker.

## **(II) ERRORS IN THE TAXPAYER RELIEF DECISION OR THE TAXPAYER RELIEF REPORT**

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

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 CRA was unreasonable and granted the application for judicial review. The 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 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 Court referred the matter back for reconsideration by a different decision-maker.

### **3. Singh v. Attorney General of Canada, 2005 DTC 5691**

The taxpayer's application for judicial review was granted. The Minister's decision to reject the application for fairness relief was based on inaccurate observations submitted by the CRA audit staff to the review officer. One of these inaccurate observations was that the taxpayer had a poor compliance history, which was not the case. Another inaccurate observation was that a debt owed by the taxpayer had been

forgiven, but the taxpayer was still being pursued by his creditor for payment. The Federal Court held that the Minister's decision ignored relevant facts or took into account irrelevant ones, and was also contrary to law. Therefore, the Federal Court ordered the matter to be returned for reconsideration by the Minister.

#### **4. Lund v. Attorney General for Canada, 2006 DTC 6367**

As a result of the CRA's first and second level fairness decisions, the Minister denied the taxpayer's request for interest relief. The Minister's position was that there were no extraordinary circumstances to justify relief being granted and that the payment of the interest would not cause undue financial hardship to the taxpayer.

The Federal Court allowed the taxpayer's application for judicial review of the Minister's decision. The Federal Court held that the fairness decision-maker failed to review, thoroughly, independently and personally all material submitted to him by other CRA personnel. The Court held that the decision-maker (i) conducted a very cursory review of the taxpayer's financial information and made little attempt to understand the true extent of the taxpayer's available cash flow and (ii) did not consider the assessing and tax collection errors made by the CRA in its past dealings with the taxpayer. The matter was sent back to the CRA for reassessment by persons previously uninvolved with the taxpayer's affairs.

### **(III) FINANCIAL HARDSHIP**

#### **5. Ross v. Canada Customs and Revenue Agency, 2006 DTC 6196**

The taxpayer made a fairness application on the basis of financial hardship. In both of the first and second level fairness reviews, the Minister denied the taxpayer's fairness application on the basis of inadequate evidence that the payment of these amounts would cause the taxpayer undue financial hardship. The taxpayer applied to the Federal Court for a judicial review of the Minister's decision.

The Federal Court granted the application for judicial review and held that in making the second level fairness decision the Minister had acted unreasonably by relying on a report that contained shortcomings i.e. (i) it took into consideration the income of the taxpayer's spouse without considering her expenses; and (ii) it gave little weight to the taxpayer's claims based on his family expenses. The Court held that the conclusions in the report regarding the taxpayers monthly cash surplus seemed unjustified. Therefore, the Minister's decision-maker did not act reasonably. The Court ordered that the review application should be returned for reassessment by another representative of the Minister.



**6. Vitellaro et al. v. Canada Customs and Revenue Agency, 2005 DTC 5275**

The taxpayers' fairness application was based on financial hardship. The Minister refused to waive interest and penalties on outstanding tax and GST owed by the taxpayers. The Federal Court dismissed the taxpayers' applications for judicial review (2004 DTC 6362). The taxpayers appealed to the Federal Court of Appeal.

The Federal Court of Appeal allowed the taxpayers' appeal on the basis that the Ministers' refusal to waive interest and penalties was unreasonable since the calculations by the CRA of the taxpayers' tax indebtedness and of the assets available to discharge the indebtedness contained serious errors for the following reasons: (i) the CRA had considered only the amount of outstanding interest and penalties and had failed to take into account the taxpayer's total outstanding indebtedness to CRA for tax, interest and penalties and (ii) the CRA official based her calculation of the corporate taxpayer's equity in a property on the original purchase price of the property and ignored the fact that the property value was substantially lower since the market had sharply declined soon thereafter. The Federal Court held that the matter should be referred back to the Minister for redetermination, taking into account this analysis.

**7. Galetzka v. Canada, 2004 DTC 6472**

The taxpayer made a fairness application on the basis of financial hardship for interest charges that had accrued on unpaid income taxes. The taxpayer had paid off all the income tax owing, together with part of the interest, but a portion of the accumulated interest was still outstanding. The taxpayer had a low income job and had been refused a loan by the bank to pay the balance of the interest.

The Minister denied the application for relief on the basis that with the combined income of the taxpayer and her husband, and the equity in their home there was sufficient ability to pay. The taxpayer applied for judicial review of the Minister's decision.

The Federal Court granted the fairness application holding that the interest and penalty should be waived since payment would result in financial hardship for the taxpayer. Although she and her husband still lived in the same home, they were living separate and apart and only maintained the common living arrangement for financial reasons. The taxpayer's husband gave her no money, except for a few hundred dollars each month for groceries, and would not consent to have a mortgage put on the house. Therefore, the only fair and reasonable decision would be to waive the outstanding interest.

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

##### 8. *Simmonds v. Minister of National Revenue, 2006 DTC 6083*

The taxpayer requested the Minister to issue a reassessment to permit the taxpayer to claim an allowable business investment loss deduction, resulting from the collapse of the corporation operating the taxpayer's family business. The Minister's position was that the taxpayer did not meet the requirements in clause 50(1)(b)(iii)(A) of the ITA since no steps had been previously taken to formally dissolve the corporation.

The taxpayer's application to the Federal Court for judicial review of the Minister's fairness decision was granted. The Federal Court reviewed the jurisprudence as to the requirements of subsection 50(1) of the ITA and concluded that the test is not whether the formalities of dissolution have been observed but whether the corporation has ceased to carry on business and will not begin to carry on business again. The Federal Court applied those principles to the taxpayer's circumstances and set aside the CRA's decision because the CRA had made a reviewable error in law.

##### 9. *Gandy v. Canada Customs and Revenue Agency, 2006 DTC 6510*

The Minister refused to waive interest and late filing penalties assessed against the taxpayer for 2001. The taxpayer applied to the Federal Court for judicial review. The Federal Court held that the Minister erred on the following grounds, the officer of the CRA who reviewed the fairness application (i) misread the law, (ii) failed to consider all the factors contained in a relevant Information Circular issued by the CRA, and (iii) determined that the payment of these amounts would not cause undue financial hardship to the taxpayer, without considering the taxpayer's total indebtedness to the CRA. The Federal Court referred the matter back to the Minister for redetermination by another person.

##### 10. *Liddar v. Minister of National Revenue, 2006 GTC 1304*

The taxpayer's son operated a business that fell into financial difficulties and the taxpayer took over its operation. The taxpayer was assured by the CRA collection authorities that if the taxpayer paid off the basic GST amount previously owing by the son's business, that the CRA would waive the outstanding interest and penalties.

In spite of this the taxpayer paid the GST amount in full together with all of the outstanding interest and penalties. Later the taxpayer made an application for fairness relief requesting that the CRA refund the amount of interest and penalties previously

paid by the taxpayer. The Minister refused to grant the taxpayer's request and therefore the taxpayer applied to the Federal Court for a judicial review of the Minister's decision.

The Federal Court granted the taxpayer's application for judicial review. The Court held that the Minister had not failed to consider the unusual circumstances of this case, which included the fact that the taxpayer, who was a third party, had paid off the GST, interest and penalties owing by the son's business on the strength of a CRA undertaking to waive the interest and penalties. The Federal Court ordered the Minister to honour the undertaking previously made by the CRA to the taxpayer and to immediately refund the interest and penalties, together with interest as provided for in the Fairness Guidelines, at the rate of 6% per annum.

**11. Underwood v. Canada, 2007 GTC 1424**

The taxpayer made an application for judicial review of a second level internal review decision. The taxpayer had been granted partial relief from interest and penalties in the first level review. The Minister refused to provide additional relief from interest and penalties in the second level review.

The Federal Court allowed the taxpayer's application finding that the taxpayer's reassessments had been improperly addressed by the CRA and possibly not received by the taxpayer. In addition to the mailing address error, the CRA officers involved with the taxpayer's file had erroneously determined that no Notice of Objection had been filed; an error that was not rectified until after the return became statute barred. The Minister was ordered to conduct a new fairness review.

**12. Dobson Estate v. Canada (Attorney General), 2007 DTC 5426**

The taxpayer applied for judicial review of the Minister's decision not to waive interest payments. The Court quashed the Minister's decision and sent it back to the Minister for reconsideration. On reconsideration, the Minister's decision was substantially similar to the initial decision before the judicial review. The taxpayer then applied for judicial review of the second decision. The Federal Court said that the issues of bias and procedural fairness must be reviewed on a standard of correctness. Since the second review was substantially similar to the first, the Court allowed the taxpayers application and referred the request back to the Minister for genuine reconsideration.



**13. McNaught Pontiac Buick Cadillac Ltd. v. CCRA, 2007 DTC 5014**

On September 20, 2005, the corporate taxpayer, a 'large employer', was required to remit employee source deductions to the CRA through a financial institution with an accompanying remittance form. The corporate taxpayer's in-house courier went to the bank to make the remittance, but upon arriving at the bank discovered the remittance form had been misplaced. The bank would not accept the payment without the remittance form.

The courier then went to the local Tax Service Office ("TSO") to submit the cheque directly. The cheque was accepted and a remittance stub was issued by the TSO. The Minister assessed the corporate taxpayer under s.226(9)(a) of the ITA since the amount was remitted directly to the TSO instead of a financial institution. The Minister denied the corporate taxpayer's first and second level relief applications on the basis that the circumstances were not extraordinary.

The taxpayer applied to the Federal Court for judicial review and the Court allowed the corporate taxpayer's application. The Minister's decision emphasized the non-existence of extraordinary circumstances, however, the Court stated that this seems to incorrectly make the assumption that the guidelines are binding and exhaustive. In addition, the Minister ignored a number of relevant factors, including whether the CRA made an 'error in processing' by accepting the cheque at the TSO office. The corporate taxpayer exercised a reasonable amount of care and the error was unforeseeable. As a result, the Court referred the matter back to the Minister for reconsideration.

**14. PPSC Enterprises Ltd. v. Minister of National Revenue, 2007 DTC 5500**

The corporate taxpayer failed to remit CPP contributions for the sole director and officer of the corporation. The corporate taxpayer acknowledged that it had not submitted the required CPP sums and paid them in full. However, the sole officer and director of the corporation had remitted the CPP amounts at issue on a timely basis based on self employment earnings that he reported in his personal tax return. The CRA credited the sole officer and director personally for the CPP amounts. The corporate taxpayer then applied for relief from the interest and penalties assessed on the CPP sums. The Minister denied relief on a first and second level review and the corporate taxpayer applied to the Federal Court for judicial review of the decision.

The Court dismissed the application for judicial review. The corporate taxpayer claimed its annual returns were prepared by a third party who advised them that directors were not considered employees. The judge recognized that the payments made by the sole officer and director were made in a timely manner and that Minister

was at no time out of pocket. However, the decision of the CRA officer was still reasonable since neither ignorance of the law nor third party errors constitute extraordinary circumstances for the purposes of a fairness application.

## (V) TIME DELAYS

### 15. **Dort Estate v. Canada, 2005 DTC 5512**

The taxpayer made a fairness request to the CRA, based on (i) the CRA's delay in processing the tax return (ii) financial hardship of the taxpayer and (iii) mental distress of the taxpayer. The first level fairness decision by the CRA did not address the CRA's delay in processing the tax return. The taxpayer made an application to the Federal Court for judicial review of the first level fairness decision. The Federal Court agreed with the taxpayer and referred the matter back to the CRA for a second level fairness review based upon the CRA's delay in processing the tax return.

### 16. **Cole v. The Attorney General of Canada, 2005 DTC 5667**

Due to litigation in the Federal Court regarding the taxpayer's 1983 taxation year, the assessment for the taxpayer's 1987-1988 taxation year was delayed. The taxpayer made a request for fairness relief from interest owing in respect of the taxpayer's 1987-1988 assessment. The Minister refused to grant any relief to the taxpayer. The taxpayer applied to the Federal Court for judicial review of the Minister's first level decision. The Federal Court granted the application for judicial review of the first level decision and referred the matter back to the Minister for reconsideration.

At the second level, the Minister granted some relief but stated that delays resulting from court proceedings are beyond the control of the CRA and are not taken into consideration in granting relief. The taxpayer made a second application to the Federal Court for judicial review of the second level decision. The Federal Court granted the taxpayer's application for judicial review. The Federal Court held that the fairness legislation does not restrict relief to situations involving delays within the Minister's control. Delays in court proceedings, depending on the circumstances, could also be considered as grounds for granting fairness relief. Accordingly, the Minister's fairness decision was quashed and the matter was again referred back to the Minister for reconsideration.

**(VI) SERIOUS ILLNESS****17. Sutherland v. Canada Customs and Revenue Agency, 2006 DTC 6151**

The taxpayer made a fairness application on the basis of serious illness in order to waive penalties and interest resulting from late filings of her 1994-2001 tax returns. The Minister waived one late filing penalty for 2000 and refused to grant any further relief on the grounds that the taxpayer's illness did not prevent the taxpayer from filing her tax returns in a timely manner. The taxpayer applied for judicial review of the Minister's fairness decision.

The Federal Court dismissed the taxpayer's application and held that the Minister's decision was reasonable. Where the taxpayer's fairness application is based on serious illness, the taxpayer must provide satisfactory evidence to prove not only the facts relating to the illness, but also that the illness directly contributed to the taxpayer's inability to comply with filing the tax returns on a timely basis.

**18. Carter-Smith v. Attorney General of Canada, 2006 DTC 6707**

The taxpayer made a fairness application on the basis of serious illness in order to waive penalties and interest resulting from late filing of her tax returns. The Minister denied the taxpayer's application on the grounds that the taxpayer was capable of self-employment during the relevant period and accordingly, should have been capable of complying with the requirements of the ITA.

The taxpayer appealed to the Federal Court arguing that the accumulation of penalties and interest resulted from circumstances beyond her control, namely (i) the stress associated with the taxpayer being the sole family caregiver for her severely ill mother and adult sister; and (ii) the taxpayer's debilitating back problems. The Federal Court granted the taxpayer's application on the basis that the Minister did not take into account and give due weight to all the relevant facts. The Minister failed to consider the taxpayer's own emotional or mental distress as well as the taxpayer's back problems. The Federal Court referred the matter back to the Minister for reconsideration by a different decision-maker.

**19. The Estate of Gary McLeod v. Minister of National Revenue, 2007 DTC 5623**

The taxpayer was a successful business man until 1999 when a series of tragedies struck his family. Both of the taxpayer's daughters became seriously ill, one died and the other required expensive treatment only available in the U.S. The taxpayer's marriage broke down, and he was involved in a catastrophic car accident

that left him injured. He developed serious mental and emotional problems as a result of these occurrences. The taxpayer failed to file timely returns during this period and the Minister imposed late-filing penalties. After submitting a request for relief, the taxpayer took his life. The Minister denied the taxpayer's fairness request. The taxpayer's estate applied for judicial review of the Minister's decision.

The Federal Court allowed the application and set aside the Minister's assessment on the basis that the Minister's decision to deny the taxpayer fairness relief was unreasonable. The Minister erred in concluding that the extenuating circumstances did not negatively impact the taxpayer's capacity to manage his financial affairs.

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