LEGAL BUSINESS REPORT | ALPERT LAW FIRM
THE TAX LAW PROFESSIONALS
1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

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 "Act") 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.

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 tax 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 10-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 tax 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 send in their request for any potential relief before the expiry of the 10-year time limit for that tax year.

The CRA has published Information Circular 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.

1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

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:

- 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 Act 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 Act, even though, unintended tax consequences resulted;

1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

(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, 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 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 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: (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, 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 within 30 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 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

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.

2. *Lanno v. Canada Customs and Revenue Agency*, 2006 DTC 6462

When the new decision maker also refused to grant the fairness relief, the taxpayer again applied to the Federal Court for judicial review, and also to the Federal

Court of Appeal for an order enforcing the 2005 order pursuant to the *Federal Courts Rules*. However, the Federal Court of Appeal was not convinced that there were any special circumstances justifying an order pursuant to the *Federal Courts Rules*. As a result, the taxpayer's motion to the Federal court of Appeal was dismissed, since he was required to pursue his remedy in the Federal Court for judicial review.

(II) 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. ***Singh v. Attorney General of Canada*, 2005 DTC 5691**

In this Federal Court of Canada decision, the Minister refused to waive the interest and late-filing penalties owed by the taxpayer.

The Federal Court granted the taxpayer's application for judicial review. 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.

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

In this Federal Court of Canada decision, 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 Federal 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.

4. ***Kerr v. Attorney General of Canada*, 2008 DTC 6642**

In this Federal Court of Canada case, the taxpayer received a Notice of Assessment that incorrectly advised that her registered retirement savings plan ("RRSP") contribution limit for 1997 was $8,121 instead of the correct limit, which was $794. Relying on this incorrect information, the taxpayer contributed $8,121 to her RRSP for the 1997 taxation year. Prior to this contribution, the taxpayer had contributed $2,000 to her RRSP, based on her understanding that taxpayers were allowed to over-contribute to this maximum without incurring any penalties.

The correct contribution limits were not known to the taxpayer until April 29, 2004, when the CRA sent her a letter containing the correct information. Along with the letter were two completed forms for withdrawing $8,121 and $1,206 from her RRSP account on a tax-free basis. However, this was a further error, as the withdrawal amount on the first form should have been $7,327 (i.e. $8,121 less $794), and a second form should not have been provided.

While the Act provides for a Part X.1 tax if the over contributions remain in the RRSP account, subsection 204.1(4) allows the Minister to waive this tax if the over-contribution occurred because of a reasonable error and if reasonable steps were taken to eliminate the excess. The taxpayer's request for waiver of the Part X.1 tax was denied by the Minister. The Minister claimed that the excess contribution was not the result of a reasonable error, and because the taxpayer failed to file her income taxes when required, she failed to take reasonable steps to eliminate the excess.

The Federal Court concluded that the Minister's decision was unreasonable, and that the process behind it was unfair. The Court's decided as follows: (i) there was a reasonable apprehension of bias, as a memorandum about the taxpayer's situation painted an inaccurate picture, (ii) the taxpayer was told a further meeting would be held prior to the decision being made, however the meeting never occurred, and (iii) the taxpayer never received a formal demand for her tax return. Thus, the decision was quashed and the matter was referred back to the Minister for redetermination.

(III) FINANCIAL HARDSHIP

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

In this Federal Court of Canada decision, 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, namely: (i) the report took into consideration the income of the taxpayer's spouse without considering her expenses; (ii) the report gave little weight to the taxpayer's claims based on his family expenses; and (iii) the conclusions in the report regarding the taxpayer's monthly cash surplus seemed unjustified given the age and the medical condition, including three car accidents and severe depression, of the taxpayer. The Federal Court held that the Minister's decision-maker did not act reasonably and ordered that the review application should be returned for reassessment by another representative of the Minister.

1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

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

In this Federal Court of Appeal decision, 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. The taxpayers appealed to the Federal Court of Appeal.

The Federal Court of Appeal allowed the taxpayers' appeal on the basis that the Minister's 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 the following serious errors: (i) the CRA had considered only the amount of outstanding interest and penalties and had failed to take into account the taxpayers' 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 of Appeal held that the matter should be referred back to the Minister for redetermination, taking into account this analysis.

3. *Galetzka v. Canada Customs and Revenue Agency*, 2004 DTC 6472

In this Federal Court of Canada decision, 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.

4. *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 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 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.

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

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

In this Federal Court of Canada decision, 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 Act 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 Act 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 on the basis that the CRA had made a reviewable error in law.

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

In this Federal Court of Canada decision, 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 claiming that the penalties were excessive and caused her financial hardship.

The taxpayer's application to the Federal Court for judicial review of the Minister's fairness decision was granted. The Federal Court held that the officer of the CRA who reviewed the fairness application erred on the following grounds: (i) the officer misread the law by considering the Guidelines set out in Information Circular 92-2 (the "Guidelines") to be binding and exhaustive; (ii) he failed to consider all the factors set out in the Guidelines; and (iii) he 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.

3. ***Liddar v. Minister of National Revenue*, 2008 GTC 1053**

In this Federal Court of Appeal decision, 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, 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 Federal Court held that the Minister had 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. This failure constituted a serious error and a breach of fundamental fairness. 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. The Minister appealed to the Federal Court of Appeal on the grounds that the Federal Court does not have the authority to order the Minister to refund the interest and penalties that have been paid.

The Federal Court of Appeal allowed the Minister's appeal in part and held that the Federal Court erred in law by ordering the refund to the taxpayer. Although the Federal Court has the authority to order the Minister to refund the interest and penalties pursuant to subsection 18.1(3) of the *Federal Courts Act*, the Federal Court of Appeal held that the facts of this case did not meet the statutory conditions for a refund under the *Excise Tax Act*. The Federal Court of Appeal found that the *Excise Tax Act* does not contemplate the refund of interest and penalties paid by one person for the account of another. As a result, the Federal Court of Appeal set aside the portion of the decision of the Federal Court that ordered the Minister to pay the taxpayer a refund. The Court of Appeal referred the matter back to the Minister for reconsideration on the basis that the taxpayer paid the penalties because he was assured by tax officials that if he did so, the interest and penalties would be waived.

4. ***Underwood v. Attorney General of Canada*, 2007 GTC 1424**

In this Federal Court of Canada decision, 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 for judicial review 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.

5. *Dobson Estate v. Attorney General of Canada*, 2007 DTC 5426

In this Federal Court of Canada decision, the estate of the taxpayer applied for judicial review of the Minister's decision not to waive interest payments. The Federal 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 estate of the taxpayer then applied for judicial review of the second decision.

The Federal Court granted the application for judicial review. The Federal Court held that the issues of bias and procedural fairness must be reviewed on a standard of correctness. The Federal Court found that if a discretionary decision is quashed on judicial review and referred back to the Minister, it must be reviewed with an open mind, based on an entirely new assessment of the case and its merits. Because the second review was substantially similar to the first, in content and in wording, the Federal Court found that the decisions were not truly independent appraisals and referred the request back to the Minister for genuine reconsideration.

6. *McNaught Pontiac Buick Cadillac Ltd. v. Canada Customs and Revenue Agency*, 2007 DTC 5014

In this Federal Court of Canada decision, 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 discovered that 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 paragraph 226(9)(a) of the Act 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 Federal Court allowed the corporate taxpayer's application. The Minister's decision emphasized the non-existence of extraordinary circumstances; however, the Federal 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 Federal Court referred the matter back to the Minister for reconsideration.

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

In this Federal Court of Canada decision, 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 Federal 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 Federal Court 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.

8. *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 Information Circular 07-1.

9. ***Spence v. The Queen*, 2010 DTC 5024**

In this Federal Court of Canada decision, the taxpayer worked as an employee for various employers. In February 2007, the taxpayer went to H&R Block to have his tax return prepared, however, in doing so, 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 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.

(V) TIME DELAYS

1. ***Dort Estate v. Minister of National Revenue*, 2005 DTC 5512**

In this Federal Court of Canada decision, the taxpayer's estate 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 estate made an application to the Federal Court for judicial review of the first level fairness decision.

The Federal Court agreed with the estate 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.

2. ***Cole v. Attorney General of Canada*, 2005 DTC 5667**

In this Federal Court of Canada decision, 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.

3. ***Telfer v. Canada Revenue Agency*, 2009 DTC 5046**

In this Federal Court of Appeal decision, the taxpayer filed Notices of Objection for the taxation years 1993 to 1999 inclusive (except 1995). With the taxpayer's consent, the CRA opted to hold the taxpayer's Notices of Objection in abeyance, as the issue raised therein was substantially similar to that in a case that was before the Tax Court of Canada at the same time. At the time of the decision, the CRA informed the taxpayer that interest would continue to accumulate on the unpaid balance. Approximately two years later, following the decision of the Tax Court in the similar case, the CRA and the taxpayer agreed on a settlement. The taxpayer applied for interest relief on the grounds of departmental delay and financial hardship. The Minister denied the request, and the taxpayer appealed to the Federal Court for judicial review.

The Federal Court allowed the taxpayer's application for judicial review. Applying the *Cole* decision, the Federal Court held that even though the taxpayer was not a party to the proceedings that caused the delay, the delay can nevertheless be a basis for relief under the fairness provisions. The Federal Court held that although the taxpayer agreed to the delay and was informed that interest would continue to accumulate, it would not be fair to impose all of the interest on her. Therefore, the Federal Court allowed the taxpayer's application and referred the matter back to another agent of the Minister, noting that the taxpayer should only be required to pay half of the interest accrued during the waiting period.

The Federal Court of Appeal reversed this decision in favour of the CRA. The Federal Court of Appeal held that the trial judge should not have intervened with the Minister's decision and made an error in law by utilizing a standard of correctness, instead of reasonableness. The Federal Court of Appeal found that when reviewing for unreasonableness, a court must examine the decision making process to ensure that it is (i) rational; (ii) transparent; and (iii) falls within a range of possible outcomes. Applying the correct standard of reasonableness, the Federal Court of Appeal held that the decision of the Minister was reasonable because the Minister: (i) was aware of all the relevant facts; and (ii) did not exclude relevant facts from consideration.

An application for leave to appeal was denied by the Supreme Court of Canada on June 11, 2009.

4. ***Lalonde v. Canada Revenue Agency*, 2010 DTC 5139**

In this Federal Court of Canada decision, the taxpayer was reassessed for his 1992 and 1993 taxation years, in connection with his investment in a tax shelter relating to flow-through shares in a mining company. In his 1992 and 1993 tax returns, the taxpayer claimed tax deductions of $9,600 and $12,000 respectively, in connection with the shares. In 1995, the CRA began an investigation concerning the exploration expenses of the mining company.

Following the investigation in 2000, the CRA sent notices of reassessment to the taxpayer for his 1992 and 1993 taxation years. There was no explanatory letter from the CRA accompanying the 2000 assessment and no subsequent correspondence between the CRA and the taxpayer. The taxpayer claims to have contacted the CRA regularly for five years regarding the progress of his file, but was never able to obtain any information. This claim was not contradicted by the CRA. The Minister denied the taxpayer's fairness request on the basis that there was no undue delay on the part of the CRA.

In a Federal Court decision, cited at 2009 DTC 5025, the Federal Court allowed the taxpayer's application for judicial review. Applying the reasonableness standard of review, the Federal Court stated that the appropriate test is whether after a "somewhat probing examination", the reasons provided by the CRA, when taken as a whole, can support the impugned decision. The Federal Court held that although it is not necessary for every element of the reasoning in the decision to pass a test for reasonableness, the reviewing judge must be satisfied that the administrative decision-maker made a reasonable decision, on the whole, after (i) fully reviewing the taxpayer's file and (ii) taking all the relevant criteria into account. The Federal Court also held that where relief is denied or granted, the Minister must provide the taxpayer with an adequate explanation of the reasons for the decision, and how the relevant factors were applied.

The Federal Court held that the CRA did not provide a reasonable explanation for a large portion of the delays since December 2001. The delays were found to be mainly due to the actions of the CRA. Furthermore, the taxpayer was not informed within a reasonable time that his file had been suspended pending decisions to be rendered in similar cases. Thus, the matter was referred back to the Minister for redetermination.

On May 13, 2008, the Minister granted further partial relief from interest for certain periods, but refused to grant relief from all interest accruing in the 1992 and 1993 assessments after December 2001. The taxpayer applied again to the Federal Court for judicial review.

The Minister's delegate in the current case argued that the taxpayer knew he had a balance owing after he received his reassessments and that it was his fault if interest then accrued because he should have paid off his balance in order to avoid that accrual. This was despite the Federal Court's decision in 2009 that the delays in processing the fairness request primarily arose because of actions of the Agency.

The Federal Court again allowed the taxpayer's application for judicial review. The Federal Court held that the Minister's delegate misinterpreted and misapplied the Fairness Guidelines. While the Minister's delegate did not take into account all the factors in the guidelines, he also did not take into account the Federal Court's 2009 decision. Therefore, the matter was referred back to the Minister for redetermination.

5. ***Guerra v. Canada Revenue Agency*, 2009 GTC 2029**

In this Federal Court of Canada decision, the taxpayer was the victim of four robberies in six months during 1991. The robberies caused the taxpayer to close its high-end retail clothing store in 1993. The taxpayer did not file any GST returns for two years prior to closing. The taxpayer requested relief for the taxation years 1991, 1992 and 1993. The Minister allowed the taxpayer partial relief for 1991 on the grounds of extraordinary circumstances, but denied the relief requested for 1992 and 1993. The taxpayer applied for judicial review to set aside the Minister's decision on the grounds that: (i) the decision to not grant relief for taxation years 1992 and 1993 was unreasonable; and (ii) the CRA failed to consider relevant facts in exercising its discretion.

The Federal Court granted the taxpayer's application, and held that the thefts were extraordinary circumstances beyond the taxpayer's control. As a result of the substantial losses and depleted inventory suffered by the taxpayer, the Federal Court concluded that the impact of the thefts was not limited to 1991. The Federal Court held that it was unreasonable to take the calendar year in which the thefts were committed as the only period where the taxpayer could not pay the taxes as a result of exceptional circumstances beyond the taxpayer's control. The CRA should have given weight to both the timing of the thefts and nature of the retail business when considering the long term effects of the theft on the taxpayer's capacity to operate the business profitably.

The Federal Court also held that the CRA did not consider all relevant factors when making its decision. Specifically, the CRA did not consider: (i) the taxpayer's history of compliance; and (ii) the diligence of the taxpayer. As a result, the Federal Court referred the matter back to the Minister for reconsideration.

(VI) SERIOUS ILLNESS

1. *Sutherland v. Canada Customs and Revenue Agency*, 2006 DTC 6151

In this Federal Court of Canada decision, 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 to 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.

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

In this Federal Court of Canada decision, 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 Act.

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 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.

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

In this Federal Court of Canada decision, 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 Federal Court held that the Minister erred in concluding that the extenuating circumstances did not negatively impact the taxpayer's capacity to manage his financial affairs.

4. *Hauser v. Canada Revenue Agency*, 2007 DTC 5217

In this Federal Court of Canada decision, the taxpayer failed to pay her income taxes for several taxation years. She applied to the Minister for a waiver of interest and penalties on the grounds of financial hardship and extraordinary circumstances, in particular, her physical and emotional health issues. Her request for a waiver of interest was denied. The Minister found no financial hardship and no extraordinary circumstances, as the taxpayer was able to maintain both her regular and business income during the time in question.

The taxpayer applied for judicial review, claiming that the CRA decision did not properly address her health issues and did not take into account the emotional distress she was under. The taxpayer maintained that the Minister should have consulted a medical professional, who would have been able to explain how it was possible for someone to be able to meet certain obligations while not maintaining others in a time of stress.

The Federal Court dismissed the taxpayer's application. It held that there is no obligation on the Minister to consult with a health care professional in making a fairness decision. The Court determined that it was not unreasonable for the Minister to

conclude that the taxpayer was merely showing a preference to other creditors over the CRA.

5. ***Lemerise v. Attorney General of Canada*, 2010 DTC 5068**

In this Federal Court of Canada case, the taxpayer filed his 2006 return nearly one year after the filing deadline. Consequently, the Minister imposed interest and penalties on the taxpayer for late filing. The taxpayer made a request for relief, seeking the cancellation of the interest and penalties. He claimed that he suffered from attention deficit hyperactivity disorder (ADHD), which was the reason behind the late filing, and that this was a situation beyond his control. However, the Minister denied this request, and also decided not to cancel the interest and penalties upon a second review. The taxpayer challenged this decision, arguing that his late filing was due to his medical condition and not because of negligence or carelessness.

The Federal Court dismissed the taxpayer's application for judicial review. In its decision, the Court cited *Young v. Canada,* 98 DTC 6028, stating that taxpayers who cite their medical condition in support of a request for relief from penalties or interest have the burden of proving that their condition was a factor beyond their control and that the interest owed was primarily caused by this factor. In this case, the taxpayer submitted a note from his doctor, however, it contained insufficient information and did not explain how his medical condition would have prevented him from filing his tax return on time. The following are examples of the types of information that a court may be seeking in a doctor's note:

(i) The recommended dosage;

(ii) The possible effects the medication may have on the taxpayer;

(iii) How long the taxpayer has been on the medication;

(iv) The taxpayer's general health (i.e. why the applicant performs well in some areas of activity and less well in others; and

(v) In what way the medication may hamper the taxpayer in his ability to perform certain tasks, such as filing his annual tax return.

Furthermore, there were gaps in the taxpayer's past filings, in that he was able to file on time in some years but not others. Thus, the taxpayer's application for judicial review was dismissed.

(VII) EXCEPTIONAL CIRCUMSTANCES

1. *Cooke v. Attorney General of Canada,* 2010 DTC 5077

In this Federal Court of Canada case, the taxpayer carried on business in the real estate field. The taxpayer had a tax liability of over $110,000. The taxpayer claimed that he was unable to pay the duties, penalties and interest claimed from him due to the major financial hardship and the state of his health. Based on these circumstances, the taxpayer made a request to the CRA to cancel the interest and penalties. The request was denied on the basis that the taxpayer had not proved financial hardship (i.e. an inability to provide himself with basic necessities and, within reasonable limits, to obtain other non-essential items). This decision was confirmed in a second review. Thus, the taxpayer applied to the Federal Court for judicial review.

The Federal Court dismissed the application for judicial review. The taxpayer submitted that the real estate crisis was similar to extraordinary circumstances as discussed in the Fairness Guidelines, as it was an event beyond his control. However, the Court held that the real estate crisis was caused by a series of decisions made by businesspeople, and did not arise out of extraordinary circumstances such as the examples provided in the Fairness Guidelines (e.g. fires, floods, and other natural disasters).

The taxpayer also submitted that he was depressed as a result of the real estate market crisis. However, the Court found that during the period under review, and notwithstanding the physician's note, the taxpayer had gone about his affairs. More importantly, during that period, the taxpayer made it a priority to pay certain creditors, to the detriment of the CRA. Thus, the Court dismissed the taxpayer's application.

2. *Paterson v. The Queen,* 2010 DTC 5130

In this Federal Court of Canada case, the taxpayer was a sole proprietor who prepared and submitted income tax returns for a number of clients electronically, using the EFILE program. With the assistance of a third party, who worked for a company that purported to campaign on behalf of charitable organizations, the taxpayer accepted money from clients who wished to "donate" to these charities in exchange for an "enhanced receipt" for tax purposes. The receipt provided to the taxpayer would reflect a much larger sum of money than was actually paid and would then be used in the preparation of each client's tax return to provide the client with a large deduction from his taxable income. For each client that purchased one of these enhanced receipts, the taxpayer received $25 from the third party involved in the scheme.

On May 1, 2009, the Minister notified the taxpayer that his EFILE privileges were revoked as of April 30, 2009 on the basis that the taxpayer's conduct was "disreputable in nature". The taxpayer sought review of this decision, arguing that he never engaged in any disreputable conduct, as he never had any reason to question the authenticity of the receipts provided to his clients.

The Federal Court held that, (i) while there is no jurisprudence concerning the applicable standard of review when assessing the decision to revoke an individual's electronic filing privileges, it is clear that the standard is that of reasonableness, and (ii) the impugned decision was reasonable. In its decision, the Federal Court found that the taxpayer knew that the amounts paid by his clients were not the same as the amounts they were given credit for when he was preparing their income tax returns. Furthermore, the taxpayer never denied his involvement in the scheme and he also admitted that he participated in the scheme for gain. Thus, the application for judicial review was dismissed.

3. ***Asper Holdings Inc. V. The Attorney General of Canada,* 2010 FC 894**

In this Federal Court of Canada case, the taxpayer was a corporation that held foreign property upon which income was earned. Under subsection 233.3(3) of the Act, a foreign income verification statement (T1135 form) is required to be filed annually when the total cost amount of all specified foreign property owned by a taxpayer is more than $100,000. The taxpayer did not file T1135 forms for each of the taxation years 2000 to 2003, as it was under the impression that T1135 forms were not required where an investment portfolio was managed by a Canadian investment manager subject to Canadian tax reporting requirements.

In April 2005, the CRA notified the taxpayer that it had not filed T1135s since 2000, and requested access to the company ledgers. On June 2, 2005 the taxpayer sent the missing T1135s along with a letter, explaining their mistaken reasons for not filing. In December 2005, the CRA imposed penalties for each taxation year for which the T1135 form was filed late. Subsequently, the taxpayer's request for relief from penalties and interest was denied. The second level fairness request was also denied, however, there was a reduction of interest charged for six months to address the lengthy delay in replying to the first request for relief. Consequently, the taxpayer filed an application for judicial review.

Among the taxpayer's list of submissions was that the decision not to file the T1135 forms was the result of confusion, and the CRA should have been more lenient about penalties. However, the Minister claimed that there was a conscious decision not

to file the T1135 forms. The Federal Court agreed that this decision was one that was lacking due diligence rather than confusion, and thus, dismissed the application for judicial review.

4. *Murphy et al. v. MNR*, 2010 DTC 5009

In this Federal Court of Canada case, a RCMP officer provided Fjoser, a team leader in the CRA's Special Enforcement Program (SEP), with a list of known or suspected UN Gang members who were likely to have unreported earned income from illegal activities. SEP conducts audits and undertakes other civil enforcement actions on individuals suspected of earning income from illegal activities. One of the tools used by the SEP is the issuance of Requirements for Information (RFIs). Fjoser prepared the RFI authorization documentation and then authorized the RFIs by stamping them with the signature of the Director of the Vancouver Tax Service Office. While the Director was authorized to sign and issue RFIs, Fjoser was not. The Applicants were personally served with the RFIs by police. One of the claims submitted by the Applicants in this judicial review was that the RFIs were invalid because they were not issued by a person authorized to do so.

The Federal Court allowed the application for judicial review. In its decision it held that the issue of whether Fjoser had the authority to decide to issue the RFIs is a jurisdictional question to be reviewed on a standard of correctness. As the Federal Court found that the issuance of a RFI was a discretionary exercise, and not a purely administrative power, the official holding the power to issue RFIs (i.e. the Director) did not have the authority to sub-delegate this power. As such, the Federal Court concluded that the RFIs were invalid.