Focus TAX LAW

Nuances of tax appeal make it unlike typical civil trial

Timothy Fitzsimmons

At best, a tax dispute with the Canada Revenue Agency may be an unwelcome and unpleasant experience for a taxpayer. In addition to the potentially complex tax issues, the dispute resolution process itself can be a nuanced and challenging process. However, an appeal to the Tax Court of Canada offers taxpayers a chance to have their disputes considered by "fresh eyes," which could result in a victory, settlement or other efficient resolution.

Generally, there are three stages to a tax dispute: audit, objection, and appeal. If the taxpayer is not satisfied with the results after the audit and objection stages, an appeal may be filed to the Tax Court.

It is an independent judicial body, and its judges act as impartial reviewers of the CRA's assessments. The federal Department of Justice (Tax Law Services Section) represents the CRA in Tax Court appeals.

If the dispute is not settled, the Tax Court will hear the matter and render a decision allowing the appeal (in whole or in part) in favour of the taxpayer, or dismissing the appeal in favour of the Crown. Decisions of the Tax Court are appealed to the Federal Court of Appeal, and ultimately to the Supreme Court of Canada (with leave), which hears only a few tax cases in any given year.

Beyond these basics, though, there are nuances to this process that make a tax appeal unlike a typical civil trial.

Jurisdiction

Just as there is no crying in baseball, there is no equity in tax law. The Tax Court is a statutory court. On an appeal, the Tax Court's jurisdiction is limited to determining the correctness of the assessment. Generally, the court cannot consider or provide relief in respect of allegations of misconduct or malfeasance by the parties. If a taxpayer alleges misconduct by the CRA or seeks judicial review of a CRA decision, the taxpayer should bring a claim/application in a provincial superior court or the Federal Court (as appropriate).

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Litigation procedure

Broadly speaking, the Tax Court has two procedures: general and informal. Where the amount of tax in issue is $12,000 or less (or the amount of losses at issue is $24,000 or less — soon to be raised to $25,000 and $50,000, respectively), the informal procedure will apply. Essentially, the informal procedure is a simplified and streamlined procedure that moves cases quickly to a hearing (akin to a small claims matter in the civil procedure). The general procedure rules have more procedural steps including discovery of documents, examinations for discovery, pre-hearing conferences, etc.

Onus of proof

In civil litigation, he who alleges must prove. In tax cases, the opposite is true (subject to exceptions for statute-barred tax years and where penalties have been imposed). The CRA's tax assessments are deemed to be valid and binding. Additionally, each assessment is based on assumptions of fact made during the assessment process. In a tax appeal, the taxpayer must adduce evidence that the actual facts were not those assumed by the CRA. This is colloquially known as "demolishing" the CRA's assumptions, and where this is done, the taxpayer will generally be successful in the appeal.

Settlements

The taxpayer and the Crown cannot simply agree to a 50-50 deal. Rather, settlements in tax cases must be "principled," which means they must be in accordance with the provisions of the *Income Tax Act* (or the particular statute under which the tax was imposed). The parties may also request a formal settlement conference before a judge to explore the possibility of early resolution of the case. Recently, the court has more strongly encouraged parties to consider or reach settlements before the hearing.

Costs

In both the general and informal procedures, the court has jurisdiction to award costs to or against a party. In the informal procedure, costs awards are typically nominal amounts. In the general procedure, costs are awarded in accordance with s. 147 of the general procedure rules, which allows the court to determine the costs payable, and prescribes a set of factors for the court to consider in making a cost award (*i.e.*, result of the proceeding, amounts in issue, importance of the issues, volume of work, etc.). The Tax Court may award costs in accordance with a tariff of fees, or it could make a lump sum award. The court has recently signalled that it intends to exercise greater discretion in awarding lump sum amounts to successful parties.

A taxpayer's journey through the audit, objection and appeal stages should not be fraught with mystery, although there are nuances to the procedures in each stage. A taxpayer should pay only the correct amount of tax owing and shouldn't be reluctant to take a tax dispute to the Tax Court.

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Income: Planning key to reduce exposure

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employer to be "carrying on business" in Canada, which the *Income Tax Act* defines very broadly. It includes the soliciting of orders or offering anything for sale in Canada, even if the sale transaction is completed outside Canada.

Any non-resident who is "carrying on business" in Canada must file a Canadian tax return. Even if it is not liable for Canadian tax because it has no "permanent establishment" (PE) in Canada under the applicable treaty, a return is required. Failure to file a return (even one which reports no liability for Canadian tax, known as a "nil" return) will lead to a penalty of up to $2,500 a year. Ironically, the cost of preparing and filing even a nil return can easily exceed that amount.

The PE question is also significant: Depending on the terms of the applicable tax treaty, an employee's presence in Canada may create a PE if the employee has, and habitually exercises in Canada, the authority to conclude contracts in the employer's name. In that case, the non-resident employer will be obliged to pay tax in Canada on the profits attributable to the PE. To avoid this, many non-resident businesses establish a policy reserving final approval over Canadian sales to employees working outside Canada.

Cross-border secondment arrangements should be approached carefully. A corporation may, for example, establish a subsidiary in another country and wish to assign certain employees to the subsidiary's premises temporarily. This will engage the transfer pricing rules that Canada and most other countries impose on cross-border, non-arm's length transactions to ensure that pricing between related parties is consistent with arm's length terms. If the pricing is too high or too low, the CRA or the tax authority of the other country may impose an adjustment to the pricing. Parties must refer to the OECD's transfer pricing guidelines and document the methodology they used to determine their pricing in order to avoid a penalty.

While compliance with these requirements may seem daunting, there are strategies available to minimize the expense and inconvenience to non-resident employers and their employees. The key to reducing the employer's tax exposure is advance planning with regard to the timing and duration of employee travel and the scope of their activities in Canada. As Yogi Berra may or may not have said: "If you don't know where you're going, you might wind up someplace else."

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