Date: 20090922

Docket: A-560-08

Citation: 2009 FCA 270

CORAM: **SEXTON J.A.**
LAYDEN-STEVENSON J.A.
RYER J.A.

BETWEEN:

CANADA REVENUE AGENCY

Appellant

and

SLAU LIMITED

Respondent

Heard at Ottawa, Ontario, on September 8, 2009.

Judgment delivered at Ottawa, Ontario, on September 22, 2009.

REASONS FOR JUDGMENT BY: RYER J.A.

CONCURRED IN BY: SEXTON J.A.
LAYDEN-STEVENSON J.A.

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REASONS FOR JUDGMENT

RYER J.A.

[1] This is an appeal by the Canada Revenue Agency (the "CRA") from a decision of Kelen J. (the "Application Judge") of the Federal Court (2008 FC 1142) granting an application for judicial review brought by Slau Limited ("Slau") to set aside a decision of the Minister of National Revenue (the "Minister") refusing to cancel certain interest and penalties that were payable by Slau pursuant to the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "ITA"), in respect of its 1988 to 1990 taxation years.

[2] The application arose out of a request by Slau pursuant to subsection 220(3.1) of the ITA. Under that provision, which was introduced in 1991 as part of the so-called “Fairness Package”, the Minister has the discretion to cancel penalties and interest payable by a taxpayer. It reads as follows:

220(3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.	220(3.1) Le ministre peut, au plus tard le jour qui suit de dix années civiles la fin de l’année d’imposition d’un contribuable ou de l’exercice d’une société de personnes ou sur demande du contribuable ou de la société de personnes faite au plus tard ce jour-là, renoncer à tout ou partie d’un montant de pénalité ou d’intérêts payable par ailleurs par le contribuable ou la société de personnes en application de la présente loi pour cette année d’imposition ou cet exercice, ou l’annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

BACKGROUND

[3] Slau was engaged in the restaurant business in Ottawa in its 1988 to 1990 taxation years. Its income tax returns for those years, which were filed late, indicated that it had no taxable income in any of those years.

[4] As a result of an audit undertaken in 1992, the CRA issued reassessments in which Slau was assessed income tax, interest and a late-filing penalty in respect of each of its 1988 to 1990 taxation years.

[5] Slau objected to the reassessments and in 1996, it reached a settlement with the CRA that led to the execution, on December 16, 1996, of an agreement entitled Disposition of Appeal on Consent (the "Settlement Agreement").

[6] In its income tax returns for its 1991 to 1993 taxation years, which were also late-filed, Slau claimed certain non-capital losses, within the meaning of subsection 111(8) of the ITA (the "Losses"), the validity of which is not in issue in this appeal.

[7] The Settlement Agreement did not deal with the Losses, although the matter of carrying the Losses back to the 1988 to 1990 taxation years may have been discussed in the negotiations that preceded the execution of the Settlement Agreement.

[8] In furtherance of the Settlement Agreement, Slau filed revised financial statements for its 1988 to 1990 taxation years. At that same time, Slau filed documents entitled "Adjustments to 1988 Income Statement", "Adjustments to 1989 Income Statement" and "Adjustments to 1990 Income Statement" in which carrybacks of certain amounts of the Losses (the "Loss Carrybacks") were specified.

[9] On February 12, 1997, the CRA issued notices of reassessment in accordance with the Settlement Agreement but did not implement the Loss Carrybacks. As a consequence, those notices of reassessment stipulated that Slau owed $134,462.44 on account of income tax, interest and penalties in respect of its 1988 to 1990 taxation years. Tangentially, it is noted that the Province of

Ontario accepted and implemented Slau's request for a carryback of the losses in the 1991 to 1993 taxation years for Ontario income tax purposes.

[10] Subsequent to the issuance of the February 12, 1997 reassessments, Slau corresponded with the CRA with respect to the Loss Carrybacks and on March 20, 2003, submitted CRA Form T2A(E) requesting the Loss Carrybacks. In that correspondence, Slau reiterated that it had requested the Loss Carrybacks at the time of the implementation of the Settlement Agreement.

[11] On June 6, 2003, the Minister corresponded with Slau, stating:

> I am informed that Ms. Aline Landry, Director of the Ottawa Tax Services Office, has accepted your request for a non-capital loss carry-back for the 1991, 1992 and 1993 taxation years. As a result, non-capital losses will be applied to the taxation years 1988, 1989 and 1990. I understand that related penalties and interest will be cancelled from December 1996; therefore the tax debt of Slau Limited will be reduced accordingly.

[12] In the ensuing reassessments, issued January 20, 2004, the Minister implemented the Loss Carrybacks which eliminated any liability for income tax in Slau's 1988 to 1990 taxation years but left it with an unpaid balance comprised of interest and penalties relating to the amounts assessed in respect of those years pursuant to the Settlement Agreement.

[13] By correspondence to the Minister, dated March 3, 2004 and August 17, 2004, Slau requested a waiver of all interest and penalties that had been assessed against it in respect of its 1988 to 1990 taxation years pursuant to the January 20, 2004 reassessments. In that correspondence, Slau indicated that it had anticipated losses in its 1988 to 1990 taxation years, and therefore did not make

instalment payments in those years. In addition, Slau argued that the Minister should have implemented the Loss Carrybacks when the Losses arose in its 1991 to 1993 taxation years, rather than in December of 1996.

[14] On October 7, 2004, the Minister denied the request for a complete waiver of all interest and penalties but decided that the amount owing by Slau was the amount owing on December 1, 1996 rather than December 16, 1996. In otherwise denying the request, the Minister stated that the Loss Carrybacks could not be implemented before there was a written request to do so from the taxpayer. In addition, the Minister stated that a waiver of interest and penalties pursuant to subsection 220(3.1) of the ITA could not be granted on the basis of an error or an incorrect assumption on the part of a taxpayer.

[15] By correspondence dated December 13, 2005, counsel for Slau made a second request for a waiver of the interest and penalties in respect of Slau's 1988 to 1990 taxation years. In that correspondence, counsel argued that because the Loss Carrybacks fully offset the amounts of income taxes owing for those years, it was illogical and unfair that Slau should have to pay any interest and penalties in respect of such income tax. In addition, counsel argued that when Slau filed its 1988 to 1990 tax returns as "nil returns", there was no tax owing because there was no taxable income.

[16] On July 6, 2006, the Minister confirmed the October 7, 2004 decision. The Minister determined that the amount owing on December 1, 1996 represented interest and penalties that had

accrued prior to the implementation of the Loss Carrybacks as of that date and that any interest charged after that date was calculated on the amount owing on that date.

[17] An application for judicial review of the July 6, 2006 decision was allowed on consent. On February 7, 2007, Mactavish J. set aside that decision and ordered that the request for a waiver of penalty and interest charges relating to Slau's 1988 to 1990 taxation be referred back to the Minister for a new review by persons not previously involved in the matter.

[18] In compliance with this order and on behalf of the Minister, Ms. Lucie Bergevin, Director of the Ottawa Tax Services Office of the CRA reviewed all of the facts of the case, including an external taxpayer relief report, dated October 11, 2007 (the "New Second Level Review Report") prepared and reviewed by CRA officials, and the submissions made on behalf of Slau. In correspondence dated November 6, 2007, in which Slau's request was once again denied, Ms. Bergevin stated:

> My review reveals no indication that an error or delay on the CRA's part, or circumstances beyond your control, would have caused additional amounts of interest arrears or penalties to be incurred with respect to the taxation years 1988, 1989 and 1990. Therefore, I have concluded that it would not be appropriate to cancel the penalty and interest charged on your client's account for those years.
>
> . . .
>
> Under 161(7)(*b*) of the *Income Tax Act*, for the purposes of interest calculation, losses carried back were correctly applied effective December 1, 1996. Any interest arrears that accumulated after December 1, 1996, were due to instalment interest and late filing penalties assessed for each year and interest on the Part I taxes that remained outstanding from the date they were due up to December 1, 1996.
>
> [Emphasis Added]

[19] This decision (the "Decision") was challenged by Slau in an application for judicial review that was filed in the Federal Court on December 7, 2007.

THE DECISION OF THE FEDERAL COURT

[20] The Application Judge determined that the Decision was reviewable on the standard of reasonableness.

[21] The Application Judge rejected Slau's argument that the effect of the Loss Carrybacks was that no taxes were ever owing by it in its 1988 to 1990 taxation years. However, he accepted, at least in part, Slau's additional argument that delay on the part of the CRA in accepting Slau's request for the Loss Carrybacks led to the imposition of some of the interest that was payable by Slau.

[22] The Application Judge found that the record indicated that Slau had requested the Loss Carrybacks as early as December of 1996. He then referred to a portion of the Decision in which the Minister stated that there was no error or delay on the Minister's part that caused Slau to be subject to additional interest or penalties. He went on to find that the CRA did delay the implementation of the Loss Carrybacks, stating in paragraph 42 of his reasons:

> [42] However, the CRA did make the error of initially denying the application of the loss carry-back; or, at least, took six years before it decided that the loss carry-back did apply and this eliminated the applicant's tax liability for 1988-1990.

[23] The Application Judge was satisfied that the amount payable by Slau, as of December 1, 1996, was appropriate. However, he determined that if the request for the Loss Carrybacks had been

granted when that request was first made in December of 1996, interest on the amount payable on that date might never have accrued.

[24] After commenting that certain CRA forms and correspondence were confusing and that Slau was not able to easily obtain clarification of the CRA's calculations, the Application Judge reached his conclusion in paragraph 47 of his reasons, which reads as follows:

> [47] The Court must conclude that the only reasonable application of fairness and equity by the Fairness Committee in this case would be to apply the CRA rationale of cancelling penalties and interest on the taxes from December 1996 to all interest after this date. According to the information received from the parties following the hearing, this means that the applicant would owe interest and penalties totalling $71,195.44.

ISSUE

[25] The issue in this appeal is whether the Minister erred in denying Slau's request, pursuant to subsection 220(3.1) of the ITA, for cancellation of all or any portion of the interest and penalties that were payable by Slau as a consequence of the January 20, 2004 reassessments.

STANDARD OF REVIEW

[26] In appellate review of a decision of a subordinate court that was engaged in judicial review of a decision of a tribunal, the appellate court is required to determine whether the reviewing court selected the appropriate standard of review and applied it correctly. (See *Canada Revi*ew *Agency v. Telfer*, 2009 FCA 23 at paragraphs 18 and 19.) Thus, in the circumstances of this appeal, the Court will be free to substitute its judgment for that of the Application Judge where the Court determines either that the wrong standard of review was selected by the Application Judge or that the correct

standard of review was incorrectly applied by him. In effect, the Court is required to conduct its own review of the Decision using the correct standard of review.

[27] In *Telfer*, this Court determined that the correct standard of review of a discretionary decision of the Minister under subsection 220(3.1) of the ITA is reasonableness. *Telfer* also provides guidance with respect to the approach to the application of the reasonableness standard. At paragraph 25 of that decision, Evans J.A. states:

> [25] When reviewing for unreasonableness, a court must examine the decision-making process (including the reasons given for the decision), in order to ensure that it contains a rational "justification" for the decision, and is transparent and intelligible. In addition, a reviewing court must determine whether the decision itself falls "within a range of possible, acceptable outcomes which are defensible in respect of the facts and the law": *Dunsmuir* at para. 47.

ANALYSIS

Introduction

[28] The record indicates that Slau made payments on account of penalties and interest in respect of its 1988 to 1990 taxation years of approximately $159,974. In making the Decision, the Minister denied Slau's request for the cancellation of the entirety of that amount, which may be regarded as consisting of two components: approximately $71,195 of interest and penalties that were owing on December 1, 1996 (the "December 1, 1996 Liability") and approximately $88,779 of interest on that amount from December 1, 1996 to the date of payment (the "Post-December 1, 1996 Accrued Interest").

[29] While the Application Judge stated that he was setting aside the Decision as unreasonable, in effect, he partially upheld it by directing in his order that on redetermination, the Minister should cancel only the Post-December 1, 1996 Accrued Interest.

[30] In this appeal, the Crown contends that the Minister's refusal to cancel both the December 1, 1996 Liability and the Post-December 1, 1996 Accrued Interest was reasonable and should be reinstated. Slau, on the other hand, accepts the decision of the Application Judge, the effect of which would be that Slau is liable to pay the December 1, 1996 Liability but not the Post-December 1, 1996 Accrued Interest.

[31] For my part, I see no reason why the Decision cannot be regarded as a composite decision whereunder the Minister refused to cancel both the December 1, 1996 Liability and the Post-December 1, 1996 Accrued Interest. Under this approach, this appeal effectively resolves itself into a question of the reasonableness of the Minister's decision not to cancel the Post-December 1, 1996 Accrued Interest, since Slau takes no issue with respect to the reasonableness of the Minister's decision not to cancel the December 1, 1996 Liability.

Selection of the Standard of Review

[32] The Application Judge determined that the standard of review of the Decision is reasonableness. In my view, having regard to *Telfer*, that determination was correct.

Application of Unreasonableness Standard

[33] In the Decision, the Minister stated that no error or delay on the Minister's part caused Slau to become liable for any interest arrears or penalties with respect to its 1988 to 1990 taxation years. This statement can be taken, correctly in my view, to mean that where an error or delay on the part of the Minister results in a taxpayer becoming liable for interest or penalties, it is appropriate for the Minister to exercise the discretion provided for in subsection 220(3.1) of the ITA and to cancel or waive such interest or penalties to the extent that they are attributable to the Minister's error or delay.

[34] The determination of whether the Minister has made an error or caused a delay for these purposes is largely a factual matter. As previously noted, the Application Judge found that the request for the Loss Carrybacks was made in December of 1996 and the Minister made an error or caused a delay in failing to accept and implement that request at that time. The Crown contends that the Application Judge erred in making these factual findings. With respect, I cannot agree with that contention.

[35] On page 2 of the Decision, the Minister states that the Loss Carrybacks "were correctly applied December 1, 1996". I take that statement to mean that having regard to the materials reviewed as a consequence of the order of Mactavish J. in the first judicial review, the Minister determined that Slau had, in fact, requested the Loss Carrybacks on or before December 1, 1996. This conclusion is consistent with a statement made by a CRA official at page 9 (Appeal Book page

256) of the New Second Level Review Report, one of the documents reviewed by the Minister before the Decision was made, wherein it is stated:

> - There is no written request prior to Dec 1996 on record. The taxpayer's representative Mr. Au-Yeung acknowledges that the loss carry-back request was only made in Dec 1996 at the time of the settlement. The CRA had no record of such a request till Mar 2003. However, due to some indications in our records that such a request might have been made at the time of the settlement the Agency gave the benefit of the doubt to the taxpayer that a request had been made in Dec 1996 – Dec 1, 1996. [Emphasis added]

[36] In my view, these statements constitute ample support for the factual findings of the Application Judge that the request for the Loss Carrybacks was made in December of 1996 and the Minister made an error or caused a delay by refusing to accept and implement that request when it was made. Moreover, these statements are inconsistent with the Crown's contention at the hearing that the selection of December 1, 1996 as the effective date for the implementation of the Loss Carrybacks was a consequence of the exercise of Ministerial discretion pursuant to subsection 220(3.1) of the ITA.

[37] The effect of the Minister's failure to implement Slau's 1996 request for the Loss Carrybacks is clear. That failure resulted in the Post-December 1, 1996 Interest Accrual. That interest would likely not have arisen, or at least it would likely not have arisen to an extent that was anywhere close to the actual amount that was paid by Slau, if the Loss Carryback request had been processed when it was originally made in 1996.

[38] What then is the effect of this failure upon the Minister's decision not to cancel the Post-December 1, 1996 Accrued Interest? In substance, the Application Judge found that the decision not to cancel the Post-December 1, 1996 Accrued Interest was unreasonable and therefore set that decision aside. In my view, that conclusion is supportable.

[39] In the Decision, the Minister stated that the CRA committed no error and made no delay that would have caused Slau to become liable for any Post-December 1, 1996 Accrued Interest. However, that factual premise, upon which the Decision is based, has been found by the Application Judge to be faulty and, in my view, no basis for interfering with that finding has been made out in this appeal. It is clear to me that a decision based upon such an important factual premise cannot be said to be "justifiable" or "intelligible", as contemplated by *Dunsmuir v. New Brunswick*, [2008] 1 S.C.R. 190, 2008 SCC 9, where that factual premise has been found to be false. Accordingly, I am of the view that the decision of the Minister to refuse to cancel the Post-December 1, 1996 Accrued Interest was unreasonable and to that extent, I agree with the Application Judge.

The Disposition of the Application Judge

[40] Having found that the Decision was unreasonable, the Application Judge determined that it had to be set aside. To that extent, I agree with his determination. However, the Application Judge, relying upon subsection 18.1(3) of the *Federal Courts Act*, R.S.C. 1985, c. F-7 (the "*Federal Courts Act")*, then proceeded to direct the Minister to exercise the discretion provided in subsection 220(3.1) of the ITA in a very specific manner, holding that there was only one reasonable way in

which that discretion could be exercised by the Minister. It is at this point that I must, with respect, disagree with the Application Judge.

[41] In this appeal, the Crown argues that the Application Judge exceeded his jurisdiction under subsection 18.1(3) of the *Federal Courts Act* by ordering the Minister to do something that was not required to be done under subsection 220(3.1) of the ITA. The Crown contends, correctly in my view, that this provision of the ITA simply requires the Minister to exercise the discretion that is provided thereunder and does not require the Minister to bring about any particular result. Unlike the Application Judge, I am of the view that, in the factual context of this appeal, the exercise of the Minister's discretion under subsection 220(3.1) of the ITA could lead to outcomes other than the one that he stipulated. Accordingly, I conclude that the Application Judge erred by imposing a single mandated outcome upon the Minister in the redetermination of the Decision that he ordered.

Conclusion

[42] Having found that the Application Judge made no error in holding that the portion of the Decision that encompasses the refusal of the Minister to cancel the Post-December 1, 1996 Accrued Interest was unreasonable but that he did err in the resulting order that he made, I am of the opinion that it is sufficient for me to simply set aside that portion of the Decision and to refer that matter to the Minister for redetermination in accordance with these reasons.

DISPOSITION

[43] For the foregoing reasons, I would allow the appeal, set aside the order of the Application Judge and, making the order that the Application Judge should have made, I would allow the application for judicial review, set aside the decision of the Minister, dated November 6, 2007, and refer the matter to Minister for redetermination in accordance with these reasons. Since success in this appeal is essentially divided, I would make no order as to costs.

"C. Michael Ryer"
J.A.

"I agree
J. Edgar Sexton J.A."

"I agree
Carolyn Layden-Stevenson"

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-560-08
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CONCURRED IN BY:	Sexton J.A. Layden-Stevenson J.A.
DATED:	September 22, 2009

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