Federal Court of Appeal | Cour d'appel fédérale

CANADA

**Date: 20100527**

**Docket: A-381-09**

**Citation: 2010 FCA 135**

**CORAM:** **LÉTOURNEAU J.A.**
**NADON J.A.**
**PELLETIER J.A.**

**BETWEEN:**

**HER MAJESTY THE QUEEN**

**Appellant**

**and**

**MARTINE LANDRY**

**Respondent**

Heard at Montréal, Quebec, on May 18, 2010.

Judgment delivered at Ottawa, Ontario, on May 27, 2010.

REASONS FOR JUDGMENT BY: LÉTOURNEAU J.A.

CONCURRED IN BY: NADON J.A.
PELLETIER J.A.

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## REASONS FOR JUDGMENT

**LÉTOURNEAU J.A.**

**Issue**

[1] Did Justice Hogan of the Tax Court of Canada (judge) properly exercise his discretion pursuant to section 147 of the *Tax Court of Canada Rules* (General Procedure) SOR/90-688 (Rules) to award costs to the parties in a proceeding? For the following reasons, I am of the

opinion that significant errors in law and in principle were made in that exercise of discretion rendering it arbitrary and requiring this Court's intervention.

**Relevant legislation**

[2] I reproduce the relevant subsections of section 147.

| COSTS | FRAIS ET DÉPENS |
|---|---|
| *General Principles* | *Règles générales* |
| **147.** (1) Subject to the provisions of the Act, the Court shall have full discretionary power over the payment of the costs of all parties involved in any proceeding, the amount and allocation of those costs and determining the persons by whom they are to be paid. | **147.** (1) Sous réserve des dispositions de la Loi, la Cour a entière discrétion pour adjuger les frais et dépens aux parties à une instance, pour en déterminer la somme, pour les répartir et pour désigner les personnes qui doivent les supporter. |
| (2) Costs may be awarded to or against the Crown. | (2) Des dépens peuvent être adjugés à la Couronne ou contre elle. |
| (3) In exercising its discretionary power pursuant to subsection (1) the Court may consider,<br>(*a*) the result of the proceeding,<br>(*b*) the amounts in issue,<br>(*c*) the importance of the issues,<br>(*d*) any offer of settlement made in writing,<br>(*e*) the volume of work,<br>(*f*) the complexity of the issues,<br>(*g*) the conduct of any party that tended to shorten or to lengthen unnecessarily the duration of the proceeding,<br>(*h*) the denial or the neglect or refusal of any party to admit anything that should have been | (3) En exerçant sa discrétion conformément au paragraphe (1), la Cour peut tenir compte:<br>*a*) du résultat de l'instance;<br>*b*) des sommes en cause;<br>*c*) de l'importance des questions en litige;<br>*d*) de toute offre de règlement présentée par écrit;<br>*e*) de la charge de travail;<br>*f*) de la complexité des questions en litige;<br>*g*) de la conduite d'une partie qui aurait abrégé ou prolongé inutilement la durée de l'instance;<br>*h*) de la dénégation d'un fait par |

admitted,

(*i*) whether any stage in the proceedings was,

(i) improper, vexatious, or unnecessary, or

(ii) taken through negligence, mistake or excessive caution,

(*j*) any other matter relevant to the question of costs.

une partie ou de sa négligence ou de son refus de l'admettre, lorsque ce fait aurait dû être admis;

*i*) de la question de savoir si une étape de l'instance,

(i) était inappropriée, vexatoire ou inutile,

(ii) a été accomplie de manière négligente, par erreur ou avec trop de circonspection;

*j*) de toute autre question pouvant influer sur la détermination des dépens.

(4) The Court may fix all or part of the costs with or without reference to Schedule II, Tariff B and, further, it may award a lump sum in lieu of or in addition to any taxed costs.

(4) La Cour peut fixer la totalité ou partie des dépens en tenant compte ou non du tarif B de l'annexe II et peut adjuger une somme globale au lieu ou en sus des dépens taxés.

(5) Notwithstanding any other provision in these rules, the Court has the discretionary power,

(*a*) to award or refuse costs in respect of a particular issue or part of a proceeding,

(*b*) to award a percentage of taxed costs or award taxed costs up to and for a particular stage of a proceeding, or

(*c*) to award all or part of the costs on a solicitor and client basis.

(5) Nonobstant toute autre disposition des présentes règles, la Cour peut, à sa discrétion:

*a*) adjuger ou refuser d'adjuger les dépens à l'égard d'une question ou d'une partie de l'instance particulière;

*b*) adjuger l'ensemble ou un pourcentage des dépens taxés jusqu'à et y compris une certaine étape de l'instance;

*c*) adjuger la totalité ou partie des dépens sur une base procureur-client.

(6) The Court may give directions to the taxing officer and, without limiting the generality of the foregoing, the Court in any particular proceeding may give directions,

(*a*) respecting increases over the amounts specified for the items in Schedule II, Tariff B,

(*b*) respecting services rendered or disbursements incurred that are not included in Schedule II, Tariff B, and

(6) La Cour peut, dans toute instance, donner des directives à l'officier taxateur, notamment en vue:

*a*) d'accorder des sommes supplémentaires à celles prévues pour les postes mentionnés au tarif B de l'annexe II;

*b*) de tenir compte des services rendus ou des débours effectués qui ne sont pas inclus dans le tarif B de l'annexe II;

| | |
|---|---|
| (*c*) to permit the taxing officer to consider factors other than those specified in section 154 when the costs are taxed. | *c*) de permettre à l'officier taxateur de prendre en considération, pour la taxation des dépens, des facteurs autres que ceux précisés à l'article 154. |

**Facts and proceedings**

[3] The respondent was working as a nude dancer at the Chez Parée club in Montréal when she met Mr. X. In 2003, she appeared on the radar screen of the Canada Revenue Agency (Agency) because of an apparent discrepancy between her assets and reported income. She therefore underwent a net worth audit for the 1998 to 2002 taxation years. The audit led to approximately $602,627 being added to the respondent's income, broken down as follows: $91,388 for 1998; $89,146 for 1999; $68,068 for 2000; $181,849 for 2001 and $172,176 for 2002. At the appeal hearing, she admitted to a reconstructed discrepancy of $529,568: see Appeal Book, Volume 13, at page 2770.

[4] The Agency's audit began on February 10, 2003. It was hampered by the respondent's uncooperativeness. The Agency was never able to meet with her. In fact, the Agency's auditor, Mr. Noiseux, stated at the March 2009 trial that this was the first time he had seen the respondent: see Appeal Book, Volume 17, at page 3736. Nevertheless, the Agency finally managed to meet with a representative of the respondent and of her common-law spouse in March 2003: see Appeal Book, Volume 7, at pages 1424 to 1428.

[5] In mid-April 2003, the respondent retained the services of a lawyer: *ibidem*, at page 1429. On May 1, a meeting took place between the respondent's lawyer, the team leader of the Agency's Investigations Division, Mr. Gagnière, and the auditor appointed to the file, Mr. Noiseux.

[6] The respondent's lawyer was told that his client's file was at the audit stage. To explain his client's assets, he put forth the hypothesis that she was perhaps being supported, unbeknownst to her common-law spouse, by someone from her past, namely, a hockey player. However, he refused to give this person's name and the information requested by the Agency to start the net worth audit off on the right track: *ibidem*, at page 1431.

[7] At a subsequent meeting on June 20, 2003, the Agency was given certain documents:

a) financial statements for the company 9051-1957 Québec Inc., owned by the respondent, for the years 1998 to 2002;

b) two copies of a purchase contract in which the company 9057-6042 Québec Inc., also owned by the respondent, acquired Class A shares of the company 9051-1957 Québec Inc.;

c) a copy of the financing contract between 9057-6042 Québec Inc., represented by the respondent, and Mr. Guérin, the creditor; and

d) a copy of a lease contract between Les Immeubles Leopold Inc. (the lessor) and 9057-6042 Québec Inc., represented by the respondent.

[8] Eight months after the start of the audit, the Agency again asked the respondent's lawyer to provide the name of the person allegedly supporting his client, the sums that she had received, the dates of the alleged payments, the method of payment and the alleged reason for the payments.

[9] The respondent's lawyer refused to reveal the identity requested and provide the other information. He insisted that his suggestion that his client had received sums of money from a hockey player was merely a hypothesis: *ibidem*, at page 1448.

[10] Faced with a refusal to provide requested information, the Agency has no choice, as it told the respondent's lawyer if he refused, but to proceed with a Requirement to Provide Information and Documents, set out at section 231.2 of the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1.

[11] The Requirement to Provide Information and Documents was mailed to the respondent on November 12, 2003: *ibidem*, at page 1451. In a letter of response to the Requirement, which letter was dated December 3, 2003, the respondent's lawyer hypothesized that there may be more than one third party supporting his client: see Appeal Book, Volume 2, at page 262.

[12] In a letter to Raymond Galimi, Director of the Laval Tax Services Office, dated January 9, 2004, the respondent's lawyer gave Mr. Galimi, in a sealed and initialled envelope, the name of a third party who had given substantial sums of money to the respondent. However, the envelope could not be opened to reveal the name to the Agency without the respondent's authorization, as she saw fit: *ibidem*, at page 267.

[13] Nonetheless, the multiple third party hypothesis resurfaced in a letter from the respondent's lawyer to the Agency dated March 26, 2004: *ibidem*, at pages 271 and 272.

[14] On May 25, 2004, a draft assessment was sent to the respondent: see Appeal Book, Volume 7, at page 1461.

[15] On July 28, 2004, approximately one and a half years after the start of the audit, the Agency still did not know the identity of the third parties who had allegedly given money to the respondent. At that point, it received a letter from the respondent's lawyer again suggesting that there was more than one party, but indicating that Mr. X was the person mainly responsible for the monetary contributions: see Appeal Book, Volume 8, at pages 1796 and 1800.

[16] Steps were then taken to meet with Mr. X regarding the business transactions with the respondent and information that he had allegedly given large and generous sums of money to the respondent. That meeting took place on October 26, 2004, and Mr. X denied three times having in any way paid substantial sums of money to the respondent between January 1, 1997, and

December 31, 2003. The interview was recorded on DVD: see Appeal Book, Volume 11, at page 2392.

[17] On November 15, 2004, the Agency's representatives met with the respondent's lawyer one last time before the assessment was finalized. The respondent's lawyer was offered the chance to make concrete submissions on the draft assessment, an offer that he turned down. He also refused to specify whether there were other third parties besides Mr. X who had paid sums of money and whether his client had made winnings at the casino during the period covered by the audit: see Appeal Book, Volume 7, at page 1465.

[18] At that time, the respondent's lawyer gave the Agency's representatives verbal authorization to open the sealed letter previously given to Mr. Galimi. The letter contained only one name, that of Mr. X, who, contrary to the false information knowingly given at the start of the audit, has nothing of a hockey player about him: *ibidem*.

[19] On June 9, 2005, the Minister of National Revenue issued a notice of assessment against the respondent for the periods at issue. On July 18, the respondent, without going through the objection process, appealed to the Tax Court of Canada. Pleadings were closed, a hearing took place from March 9 to 13, 2009, and the Tax Court of Canada rendered its judgment on August 10, 2009.

[20] A notice of appeal was filed with this Court on September 25, 2009, in which the appellant challenged the higher costs of $35,000 awarded to the respondent.

[21] I refrain from relating certain facts at this point in order to avoid repetition later. I will address and consider them in the analysis of the decision under appeal.

**Analysis of the decision and parties' submissions**

[22] Relying on the decision of this Court in *Lau v. Canada*, [2004] F.C.J. 35, at paragraphs 4 and 5, the respondent notes that section 147 of the Rules vests the judge with a highly discretionary power to award costs. A reviewing court may not substitute its opinion for that of the judge. I agree, but this Court also points out that discretion must be exercised on a principled basis: *ibidem.*

[23] The appellant alleges that, here, three errors of law and two errors of fact were made in this exercise of discretion rendering it arbitrary and unlawful. Let us consider these allegations.

**The judge misinterpreted Rule 147 and therefore misapplied it in considering conduct prior to the proceedings**

[24] The judge has the power to fix a lump sum for costs, in excess of the sum that would have resulted from the usual application of the Tariff provided for in the Rules. To do so, the judge must normally consider the conduct of the parties during the proceedings. This can be seen from the factors listed at Rule 147 and the case law: see *Hunter v. Canada*, 2003 D.T.C. 51 (TCC) and the case law cited therein. Only in exceptional cases may the Court take into account conduct prior to the proceedings: *ibidem*, see also *Merchant v. Her Majesty the Queen*,

2001 FCA 19, where the taxpayer's conduct frustrated the audit process, and unduly and unnecessarily prolonged the hearing, *Merchant v. Canada*, [1998] 3 C.T.C. 2505, 98 D.T.C. 1734 (CCI).

[25] With respect, the judge misinterpreted the law and facts in this issue in faulting the auditor for having failed to conduct a reasonable investigation into the merit of the statements made by the appellant regarding her generous benefactor. If there was a failure at the audit level, it was on the part of the respondent, as will be seen below.

[26] She and her spouse never met with the auditor, whereas, in 99 per cent of audit cases, taxpayers agree to meet with the auditor: see Mr. Noiseux's testimony, Appeal Book, Volume 17, at pages 3735, 3736 and 3756, where the witness states that the audit division was forced to proceed with the Requirement to Provide Information and Documents, given the lack of cooperation.

[27] Furthermore, up until the very last minute, the respondent hid her donor's identity, while floating the idea that it was merely a hypothesis and that there might also be more than one donor: see paragraphs 6, 8, 9, 11, 12, 13 and 15 of these reasons. In fact, when, as far as she knew, the audit was approximately 85% completed, the respondent still refused to reveal her benefactors' names and addresses, even though she knew that there was only one: see Appeal Book, Volume 7, page 1448, and Volume 17 at pages 3678 and 3754 to 3756.

[28] It is cold comfort, and of no help to the audit, for an auditor to be told that a sealed envelope, which may not be opened without the consent of a respondent who refuses to give it, contains information that is necessary and crucial to the effective and proper exercise of his or her authority to audit. How, in such circumstances, can one blame the auditor for the respondent's uncooperativeness without acting arbitrarily? I think that the answer is evident.

[29] The respondent had recorded telephone calls from Mr. X during the period covered by the audit in which he described himself as a [TRANSLATION] "generous benefactor" and stated that he was prepared to say anything to the Agency's auditor during his meeting with him on October 26, 2004: see Appeal Book, Volume 5, at pages 873 to 884.

[30] However, it was only at the stage of the appeal before the Tax Court of Canada that she revealed the existence and contents of the telephone messages. She never did it at the audit stage. Given that Mr. X formally denied three times that he had made gifts of large sums of money to the respondent, the Agency was entitled to ask the Court to rule on the credibility issues raised by the respondent's appeal, without incurring the Court's wrath for having exercised its right in the public interest.

[31] At paragraph 64 of his reasons, the judge wrote the following:

> [64] That said, I believe on the other hand that if the appellant had made available to the CRA some of the evidence submitted during the trial, the CRA's attitude might have been different. I therefore believe that the appellant is partly responsible for the length of the proceedings.

When this significant fact is added to the lack of cooperation during the audit period, it can only come as a surprise that the Agency was then ordered to pay costs higher than what is normally awarded by the Tariff.

[32] At the hearing, the judge, clearly in possession of all the facts at that point, considered the possibility of an offer to settle before trial, given that there were reputations to protect. The auditor, Mr. Noiseux, answered that the respondent had not cooperated and discussed a settlement: see Appeal Book, Volume 17, at pages 3749 to 3751 and 3778. Two parties are required in order to discuss a settlement, and the auditor was never able to meet with the respondent and her spouse. Essentially, the respondent's strategy was to say "prove the asset discrepancies, and then we will see".

[33] Further, let us not forget that, legally, the respondent bore the burden of explaining the source of the large sums of money in her possession during the periods at issue. She could have done this at the audit stage. She did not do so. Rather, she chose to go directly to trial, without even going through the objection process and discharging her burden at that point. The Agency cannot be blamed for the fact that the respondent chose a trial and refused to cooperate for an out-of-court settlement.

[34] Overall, the judge exercised his discretion under Rule 147 by taking into account factors prior to the proceedings and external to the parties' conduct at the proceedings, even though the exceptional circumstances required for him to do so did not exist. In acting as he did, he

exercised his discretion in a manner contrary to established principles. In fact, if there are exceptional circumstances, they are in favour of the appellant.

**The judge erred in his interpretation of Rule 147 in inferring from it a power to sanction nonexistent obligations**

[35] On this subject, the appellant faults the judge for having created a threefold obligation for the Agency: to conduct an investigation into the merit of the statements made by the respondent regarding Mr. X, to conduct an investigation into Mr. X's affairs and businesses and, lastly, to explain the sources of the respondent's income.

[36] The appellant bases the first two allegations on paragraph 63 of the reasons for decision, which reads as follows:

> [63] After hearing the evidence as a whole and listening to the testimony of Mr. X, I must find that the CRA failed in its duty to conduct a reasonable investigation into the merit of the statements made by the appellant regarding Mr. X. Moreover, if the CRA had pushed its investigation with Mr. X further, it would have easily been able to discover the truth and the existence of the gifts. The CRA had the authority to conduct such an investigation or audit of Mr. X. Moreover, Mr. Noiseux had no possible explanation as to the sources of the appellant's income. In his testimony, he admitted that the tax accounts of the appellant's companies were in order and he had no indication of unreported income. In most cases where net worth assessments are made and confirmed by the courts, there is found to be unreported income from taxpayers' businesses. Mr. Noiseux had no valid grounds for believing Mr. X's version of the facts, namely that there were no cash gifts.
>
> [Emphasis added]

[37] Even though the judge recognized in his reasons that the respondent has the obligation to rebut the Minister's assumptions, it is surprising to see that he created an obligation on the part

of the Agency to conduct investigations into third parties to corroborate or try to disprove the respondent's statements. Taxpayers are the ones who have information on their affairs, and it is up to them to provide it and discharge their burden of proof, especially in cases of net worth assessments. Contrary to what the judge wrote, it was not up to the auditor to provide a "possible explanation as to the sources of the [respondent's] income": see paragraph 63 of the judge's reasons for decision.

[38] Furthermore, it was practically impossible to conduct an investigation into Mr. X, since it was not until October 26, 2004, that the auditor learned that Mr. X was the generous donor. The Agency immediately confronted Mr. X with the respondent's statements, and he formally denied them three times. The Agency might have known that Mr. X was not telling the truth had the respondent revealed the existence and contents of the voice recordings.

[39] At paragraph 62 of his reasons for decision, the judge acknowledged this when he wrote the following:

> [62] . . . However, in a system based on self-assessment, when the Minister notices increases in net worth unexplained by a taxpayer's income, the taxpayer has an obligation to provide the Minister with clear explanations. It should also be noted that the conduct of Mr. Noiseux might have been different if the evidence possessed by the appellant (including voice recordings) had been made available to him.

[40] However, the fact is that this evidence was hidden from the auditor in the audit phase. Contrary to what the judge wrote, the auditor, kept in the dark and out of the loop as he was by the respondent, had no valid grounds at the audit stage for not believing Mr. X's version of the

facts, that is, that there were no cash gifts. When the concealed evidence was brought to the Agency's attention, the appeal proceedings had already been initiated by the respondent.

[41] To justify awarding increased lump-sum costs, the judge erred in imposing obligations on the Agency that it does not have and shifting to the Agency the burden of proof that falls on the respondent. In this regard as well, judicial discretion was not exercised according to established principles.

[42] This leads me to consider the appellant's final two submissions regarding the judge's alleged errors of fact.

**The judge made errors of fact in concluding that the auditor was biased in favour of Mr. X and failed to conduct a normal audit in the respondent's file**

[43] At paragraph 61 of his reasons for decision, the judge wrote the following:

> [61] . . . According to Mr. Ouellette, Mr. X was treated with deference during his interview with the CRA. Mr. Noiseux did not conduct an in-depth investigation; he accepted without any basis for so doing the version of the facts given by Mr. X, a businessman, rather than believe the appellant, a former erotic dancer. In my opinion, Mr. Noiseux's conduct amounted, in the circumstances, to an unfounded bias in favour of Mr. X because of his social standing, which bias would have been dissipated by an investigation and a normal audit of Mr. X or his businesses. Mr. Ouellette argued that Mr. X's conduct was suspicious from his first meetings with the CRA and that if Mr. Noiseux had followed normal procedures, the CRA would have discovered the existence of the large gifts that Mr. X had made to the appellant.
>
> [Emphasis added]

[44] The judge endorsed the submissions of counsel for the respondent. With respect, those submissions were not supported by the evidence.

[45] There was no evidence, and counsel for the respondent was unable to point to any, that "Mr. Noiseux's conduct amounted, in the circumstances, to an unfounded bias in favour of Mr. X because of his social standing", as the judge stated. This is mere speculation, and the judge's finding or inference of fact is capricious and unreasonable.

[46] The same can be said for the judge's finding that the auditor's bias would have been dissipated by an investigation and a normal audit of Mr. X or his businesses. In fact, this finding is contrary to the evidence because Mr. X and his businesses had recently been audited, and everything was in order: see Appeal Book, Volume 11, at page 2390.

[47] There was nothing in Mr. X's conduct to suggest to the auditor that he was concealing information. He agreed to a meeting with the Agency and to the recording of the interview, and he answered the questions that he was asked.

[48] The auditor did not know that the respondent had received bags of cash. He was surprised to learn, during the proceedings brought by the respondent, that recordings had been made of telephone conversations between the respondent and Mr. X, when he had never been told of this fact and of the contents of the recordings during the audit process.

[49] Lastly, he also discovered after the audit that certain documents relating to the sale of a building, including the acquittance, had not been sent to him despite having being in the respondent's possession.

[50] The evidence shows that the auditor followed the normal audit procedure but that his effectiveness was impaired by the respondent's strategy of non-cooperation. Again, the judge's finding that the normal audit procedure had not been followed is unreasonable because it is contrary to the evidence. It cannot be used to support the discretion to increase costs in favour of the respondent.

**Conclusion**

[51] The income tax system is based on self-assessment. Each year, taxpayers are required to report their income for the current taxation year in an honest and forthright manner. Inevitably, challenges arise regarding each side's respective assessments of the income reported, income earned and taxes claimed, if any.

[52] A dispute over taxes is no different from ones in other areas of law, in that it raises credibility issues. This is especially true in taxation when the taxpayer's assessment is based on the net worth method. The taxpayer is then asked to explain the discrepancy between the income reported and his and her net worth. The explanation provided may be sufficient to close the file. However, it may also be somewhat credible and, in some cases, simply not believable.

[53] Both the Agency and the taxpayer are entitled to apply to the court for a decision on credibility issues. Although the Agency has the obligation of verifying the existence of certain reported facts, it does not bear the burden of investigating into the conduct of a third party who is a stranger to the dispute in order to try to establish that the taxpayer is not telling the truth or corroborate his or her statements. The onus rests on the taxpayer to rebut the assumptions on which the Minister bases the assessment.

[54] The power to award costs and determine the amount is discretionary, not arbitrary. This discretion must be exercised according to established principles that are relevant to the purpose of the discretion exercised. In this case, the exercise was erroneous and capricious.

[55] For these reasons, I would allow the appeal with costs. In light of the respondent's uncooperativeness during the audit, the false information that she provided and the information that she concealed, which would have given rise to a possible settlement and precluded a costly hearing, I would set aside the judge's cost order and replace it in court file 2007-3211(IT)G with an order stipulating that each party is to bear its own costs of the proceedings in the Tax Court of Canada.

"Gilles Létourneau"
J.A.

"I agree
M. Nadon J.A."

"I agree
J.D. Denis Pelletier J.A."

Certified true translation
Tu-Quynh Trinh

**FEDERAL COURT OF APPEAL**

**NAMES OF COUNSEL AND SOLICITORS OF RECORD**

| | |
|---|---|
| **DOCKET:** | A-381-09 |
| **STYLE OF CAUSE:** | HER MAJESTY THE QUEEN v. MARTINE LANDRY |
| **PLACE OF HEARING:** | Montréal, Quebec |
| **DATE OF HEARING:** | May 18, 2010 |
| **REASONS FOR JUDGMENT BY:** | LÉTOURNEAU J.A. |
| **CONCURRED IN BY:** | NADON J.A.<br>PELLETIER J.A. |
| **DATED:** | May 27, 2010 |

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| Yves Ouellette | FOR THE RESPONDENT |

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