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SIMPLIFYING THE RESOLUTION OF TAX DISPUTES IN CANADA

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Canada has a world-class tax dispute system. For the most part, participants engage in the process in good faith, act with integrity, and treat all parties with fairness. We shouldn't forget this. But our tax dispute process can and should be simplified.

In this article, we present several recommendations for reform. We expect that these measures would enhance efficiency and speed the resolution of tax disputes while protecting the broader integrity of the tax system.

Background

Canada's self-assessing tax system is a "pay and chase" model: the CRA processes taxpayers' returns, confirms taxpayers' filings, collects amounts owing, and refunds overpayments. Then the agency reviews and audits selected taxpayer files. If reassessments are issued, the CRA's Appeals Branch may be called on to resolve any disputes through an administrative process. All of this happens before a matter reaches court.

Although the system has served stakeholders well, it is in some respects inefficient. As tax compliance grows more complex and the volume of tax litigation increases, policy makers should be seeking ways to create a simpler, fairer, more efficient tax dispute system.

We acknowledge that some progress has been made. The TCC has sought to improve efficiency by promoting case management and large group appeals, the use of expert panels, the remote commissioning of affidavits, common books of authorities, procedures for virtual and hybrid hearings, and a preliminary ruling docket. But much more could be done to simplify the system. Below are some specific suggestions.

Single Unified Tax Court

In the wake of the SCC decision in *Dow Chemical Canada ULC* (2024 SCC 23), there is clearly a system of split concurrent jurisdiction in Canada. The TCC hears appeals that challenge the correctness of assessments, while only the Federal Court can review discretionary decisions of the minister of national revenue. The result is a parallel and sometimes confusing system for challenging audit procedure and assessments. Where there is uncertainty about which court has jurisdiction, taxpayers facing a ticking clock may initiate parallel processes to protect their rights.

In *Dow*, the SCC stated that any streamlining would require parliamentary action. In our view, the time has come for such action. We recommend that the relevant statutes (the Federal Courts Act, sections 18 to 18.5, and the Tax Court of Canada Act, section 12) be amended to give the TCC jurisdiction to undertake judicial review of the minister's discretionary decisions. This would make the TCC a "one stop shop" for all matters relating to tax disputes, simplifying the situation for all concerned.

Settlements

Despite the good-faith efforts of taxpayers and the CRA to reach satisfactory resolutions of tax disputes, a structural impediment to settlements has persisted for decades. The problem goes back to an antiquated principle first articulated in *Galway* (1974 CanLII 2465 (FCA)) and reiterated in *CIBC World Markets* (2012 FCA 3). According to this principle, any out-of-court settlement of a tax dispute must produce an outcome that the court could potentially have ordered. This prohibits settlements that "split the difference" solely to reflect the parties' shared interest in avoiding litigation costs or risks. Continued observance of this principle hinders the resolution of disputes through compromise.

In 1966, the Carter commission recommended a legislative "offer of compromise" procedure for settlements of amounts owing. Precedents for such a compromise provision exist in other jurisdictions, but none has ever been included in the ITA. The time has come to add a "risks of litigation" provision to the ITA and thereby allow in Canada —as in the United States, the United Kingdom, Australia, and New Zealand—pure compromise settlements in tax disputes.

This type of compromise provision already exists in some provincial tax statutes in Canada (for example, the Ontario Employer Health Tax Act, section 22). The Ontario provision states that when uncertainty exists regarding liability to pay an amount assessed, or when special circumstances make it inequitable to demand payment of the entire amount, the tax authority may accept, in satisfaction of the tax debt, "such amount as the Minister considers proper."

Such a provision should be added to the ITA and could be accompanied by CRA guidance and a review and approval process within the agency. In our view, this rule should be unavailable in situations where the taxpayer was grossly negligent or where the tax debt arose because of the application of the general anti-avoidance rule. The fair application of this mechanism could simplify the tax dispute process while protecting the integrity of the tax system.

A New Simplified Procedure in the TCC

Under current TCC rules, appeals may proceed under either a streamlined "informal" procedure (generally for smaller matters) or the more complex "general" procedure. We recommend a third alternative—specifically, a modified procedure for cases that exceed the monetary threshold for the informal procedure but are appropriate, owing to their facts and circumstances, for a simplified procedure.

There is precedent for this in other jurisdictions. Rule 76 of the Ontario Rules of Civil Procedure, for example, contemplates a simplified procedure for civil matters; this rule could be used as a model. Under rule 76, the simplified procedure is mandatory if the amount claimed is $200,000 or less and certain other conditions are met; it is optional for certain larger claims. It allows litigation to proceed in an expedited manner through the early exchange of affidavits of documents, witness lists, and trial plans; and through the conduct of limited discovery (limited to three hours maximum) and mandated settlement discussions.

We suggest that, owing to the unique nature of tax disputes (the parties are not strangers by the time they arrive at court), there is a category of tax cases that—although they would normally fall into the broad general procedure—are suitable for expedited simplified procedures. An expedited procedure for such cases becomes all the more compelling as the volume of tax disputes increases and puts ever more pressure on the TCC's limited resources. The TCC rules should be amended to provide for a more streamlined, simplified procedure.

Proportionality in the Discovery Process

By the time a matter reaches the TCC, which normally happens only after audit and review by the CRA's Audit and Appeals branches, the parties to the dispute generally know the case to be met. Furthermore, proposed expanded audit powers give the CRA more scope and reach to collect and verify facts than ever before. It is therefore particularly appropriate that the discovery phase of tax litigation reflect a principle of proportionality. Applying this principle involves weighing the probative value of a particular document or fact against the expense of producing the document or answering a question.

Proportionality in TCC discovery, while not a principle enshrined in the General Procedure rules, is embodied in the interpretive rule in section 4(1) and in the partial disclosure rule in section 81 of these rules. By default, documentary disclosure is limited to "partial" disclosure, under which a party need produce only those documents that may be used in evidence at trial.

But the scope of oral discovery is much broader. Section 95 of the rules requires that a party being examined for discovery answer "any proper question relevant to any matter in issue." This loose relevance threshold runs counter to the principle of proportionality. In disputes about the scope of proper questions on discovery (for example, *Burlington Resources Finance Company*, 2017 TCC 144), the TCC has wrestled with the balance between relevance and proportionality.

We suggest that the TCC's rules should be amended in two ways: (1) by adding a specific rule on proportionality, and (2) by limiting oral discoveries.

In Ontario, rule 29.2 enshrines proportionality as a principle of discovery in civil disputes. The rule identifies a series of factors to be considered in determining when a document must be produced or a question answered. These factors include cost, time, prejudice, undue interference with the process, volume of documents, and the general availability of the information or documents sought. An equivalent provision should be added to the TCC rules.

The TCC rules regarding oral examinations for discovery should also be revised to prescribe a limit of seven hours for each side. In some provincial jurisdictions, this has become the standard time limit on each party's examination of the other's nominee (see, for example, rule 31.05.01 in Ontario and rule 7-2 in British Columbia). Extensions may be sought on consent or with leave of the court.

Tax disputes lasting for many years do not need an exhaustive duplicate fact-finding process once the matter reaches the TCC. Proportionality in documentary discovery and a general limit on the length of oral discovery will focus the parties and move cases through pre-trial processes efficiently.

Arbitration

As the resources of the TCC become further strained, alternative dispute resolution (ADR) mechanisms, including arbitration, offer another way to simplify and expedite the resolution of tax disputes. Such processes are not uncommon in other tax systems, such as Australia's and Portugal's. The Canada-US income tax convention (in article XXVI(6)) also has an arbitration provision to resolve certain interjurisdictional disputes.

Australia could be a model for Canadian reforms. The Australian tax system has a robust and nuanced tax dispute process. The Australian Tax Office (ATO) has not only legislative authority to settle cases by way of compromise but also a code of settlement that guides the settlement of tax disputes. In a practice statement (PS LA 2013/3) on the use of ADR in tax disputes, the ATO states (at paragraph 5):

> When disputes cannot be resolved by early engagement and direct negotiation, the ATO is committed to using ADR where appropriate to resolve disputes. It is important to recognise though that not all cases are suitable for ADR. In cases where ADR is suitable, the ATO and the taxpayer should choose a process which is suited to the circumstances and the nature of the dispute.

Canada could use such a flexible approach to streamline and expedite the resolution of certain kinds of tax disputes.

Conclusion

The CRA has expansive audit powers, and taxpayers are required to report ever-increasing amounts of information. Both parties must dedicate scarce resources—potentially over several years—to managing audits and objections. The parties are hardly strangers when they arrive at the TCC.

It is time for the Canadian rules to better reflect this reality. The reforms discussed in this article would, in our view, simplify and improve the process for resolving tax disputes, benefiting all stakeholders.

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