Catch-22: A Principled Basis for the Settlement of Tax Appeals

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PRÉCIS
Le présent article passe en revue les obstacles qui s’opposent au règlement efficace des appels interjetés en matière d’impôt et il se penche notamment sur le paradoxe selon lequel même si le règlement des différends en matière d’impôt est motivé par l’incertitude du résultat, la jurisprudence indique que les règlements ne reposant pas sur la certitude de la loi sont inexécutoires. L’article examine les méthodes de règlement d’un appel en matière d’impôt avant l’instruction et présente une analyse critique de la jurisprudence qui exige que les règlements soient raisonnés, ainsi qu’une analyse générale du droit s’appliquant à la discrétion exercée par le ministre. Pour terminer, l’article donne quelques suggestions en vue d’une réforme, et il recommande principalement que la Loi de l’impôt sur le revenu soit modifiée pour qu’elle intègre des dispositions expressément conçues pour rechercher un compromis en matière de différends fiscaux, lesquelles existent déjà au Royaume-Uni et aux États-Unis.

ABSTRACT
This article reviews the obstacles to the efficient settlement of tax appeals and, in particular, the paradox that, while the settlement of the tax disputes is motivated by uncertainty as to outcome, the jurisprudence suggests that settlements not based on certainty in the law are unenforceable. The article reviews the methods for settling a tax appeal before trial and comments critically on the jurisprudence requiring that settlements be “principled” and the law dealing with ministerial discretion more generally. It concludes with some suggestions for reform, principally a recommendation that the Income Tax Act be amended to provide expressly for compromising tax disputes, similar to existing measures in the United Kingdom and the United States.

KEYWORDS: APPEALS ■ SETTLEMENT ■ ADMINISTRATION

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Canadian governments and courts have become increasingly concerned with issues relating to access to justice, including both access to legal representation and overly complex court procedures that result in delays and increased costs. In this connection, McLachlin CJ has noted:

Courts and judges are seeking to improve access to justice by streamlining and opening their procedures and promoting efficient and early dispute resolution.¹

In the taxation area, efforts to provide more efficient and accessible dispute resolution include recent attempts to enhance the use of pre-hearing conferences in the Tax Court of Canada and making available mediation or arbitration as dispute resolution tools (although these have been little used to date).

It is becoming increasingly obvious, however, that there are statutory and jurisprudential obstacles to settling tax appeals in a fast and efficient manner, which should be addressed as part of the wider attempt to broaden access to justice. This article reviews those statutory and jurisprudential obstacles and suggests ways in which this issue can be moved forward.² In particular, it identifies the “Catch-22” referred to in the title of the article:³ the paradox that settlement agreements are made in response to uncertainty as to the outcome of a tax dispute while the existing case law suggests that agreements not based on certainty in the law are not enforceable. This case law is analyzed in the second section of the article. Specifically, the case law stipulates that the minister is not bound by any settlement reached that is not principled—indeed, that such a settlement is “illegal”—even if the taxpayer relies on the settlement to his or her detriment. Some cases have suggested that the

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² This article does not consider the Canada Revenue Agency’s (CRA’s) advance tax rulings procedure, where a similar principle applies: see The Queen et al. v. Harris, 2000 DTC 6373 (FCA); leave to appeal dismissed [2000] SCCA no. 364; and Rothmans, Benson & Hedges Inc. v. MNR, [1998] 2 CTC 176, at 181-82 (FCTD), per Richard J.
³ With apologies to Joseph Heller, author of the well-known novel of that name.
minister is not bound by any settlement, even if principled. However, the jurisprudence is unclear as to whether the taxpayer is equally free to repudiate a settlement agreement (whether principled or unprincipled), at least where the taxpayer has waived the right of appeal. The jurisprudential roadblocks to effecting the settlement of tax disputes are based on the premise that the minister has no discretion under subsection 220(1) of the Income Tax Act to make “unprincipled” or “compromise” settlements. The effect of subsection 220(1) on ministerial discretion to settle tax disputes is examined in the third section of the article. The fourth section presents suggestions for reform.

Settlement agreements play an important role in the tax litigation process, as evidenced by the fact that a significant proportion of tax cases are in fact settled prior to hearing, and therefore earlier in the dispute resolution process. While tax disputes that are settled before an appeal to the court is commenced do not require the same formal settlement procedure, they are often influenced by similar considerations. The jurisprudential barriers to a more efficient settlement of tax litigation apply equally at the pre-litigation stage; it is thought that Canada Revenue Agency (CRA) appeals officers, for example, may be reluctant to agree to settlements that are not “principled,” possibly because of concern that such agreements may expose them to criticism by the auditor general. Tax disputes that are settled at the litigation stage may therefore represent the tip of the iceberg, given that more than 90 percent of objections are settled in the internal CRA appeal’s process. These considerations only add to the salience of the discussion that follows.

Settlements of income tax appeals to the Tax Court of Canada are implemented using one of two methods:

1. filing a consent to judgment with the Tax Court; or
2. reaching an agreement under subsection 169(3) of the Act.

A consent to judgment outlines the basis on which the minister of national revenue is to reassess the taxpayer in order to implement the settlement, and is signed

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4 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.

5 The Appeals Branch of the CRA typically receives between 60,000 and 70,000 objections annually relating to income tax, goods and services tax/harmonized sales tax, excise tax, Canada Pension Plan, and employment insurance. Approximately 92 percent of these objections are resolved administratively; of the remaining 8 percent that are appealed to the courts, about 28 percent are withdrawn by the taxpayer, 35 percent are settled before being heard by the courts, and the remainder are heard: notes for remarks by Fred O’Riordan, assistant commissioner of the Appeals Branch, at a Canadian Tax Foundation conference, “Pre-Hearing Conferences in the Tax Court,” June 15, 2009. These statistics are consistent with those noted in Paul Hickey, “Appeals and Tax in Dispute” (2007) vol. 15, no. 1 Canadian Tax Highlights 2; and the Report of the Technical Committee on Business Taxation, infra note 66, at 10.8.

6 Subsection 169(3) was added by SC 1994, c. 7, schedule VIII, section 100(2), effective June 10, 1993.
by both parties. A consent to judgment is filed with the Tax Court, and if it is acceptable, the court issues judgment accordingly.\(^7\)

Subsection 169(3) provides that the minister may, “for the purpose of disposing of an appeal” under the Act and with the consent in writing of the taxpayer, reassess tax, interest, penalties, or other amounts payable under the Act, notwithstanding the time limits for reassessment set out in section 152. Subsection 169(3) permits the taxpayer and the minister to agree in writing to dispose of a tax appeal—and, in fact, agree that the minister may reassess other years that are not the subject of the appeal and are otherwise statute-barred—without the necessity of a formal judgment of the Tax Court. Typically, the terms are reduced to minutes of settlement that are not filed with the Tax Court. As one of the terms of settlement, the taxpayer agrees to discontinue the appeal and provides to the Department of Justice a notice of discontinuance, which will be filed with the Tax Court once the assessment is issued in accordance with the terms of settlement. Thus, in contrast to a consent to judgment, neither the Tax Court nor the public becomes aware of the terms of a settlement under subsection 169(3).

**THE REQUIREMENT OF A LEGAL BASIS FOR SETTLEMENT**

**The Galway and Cohen Decisions**

Much has been written about the settlement of tax litigation, primarily dealing with practical considerations.\(^8\) Unlike civil litigation, where negotiated settlements are commonly reached on “compromise” or cost-benefit analysis alone, taking into

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7. Under section 170 of the Tax Court of Canada Rules (General Procedure) (herein referred to as “the TCC rules”), when a consent to judgment is filed with the Tax Court, the court may grant the consent sought without a hearing, direct a hearing, or direct that written representations be filed.

account the inherent uncertainty of litigation and the costs involved (that is, based on “litigation risk”), in tax appeals the prevailing view is that settlements must be “principled”—that is, the settlement must reflect the correct application of the law to the facts.

Although a tax appeal may be settled on consent, the Federal Court of Appeal has held not only that there must be a legal basis under the Act for any settlement agreement entered into by the minister, but also that any agreement that lacked a legal basis would be illegal and unenforceable against the Crown.

The requirement of a legal basis for settlement was first stated by the Federal Court of Appeal in *Galway v. MNR*. In *Galway*, the sole issue in dispute was whether the amount of $200,500 received by the appellant in the course of his business as a broker should have been included in his income or whether the amount was a tax-free gift. There was no dispute as to the quantum of the amount received, and if it was income, the tax owing, alone, was $133,381.58. The taxpayer had first appealed, unsuccessfully, to the Federal Court Trial Division, and subsequently the parties had reached a settlement. The appellant then made an application in writing to the Federal Court of Appeal for a consent judgment, the effect of which would have been to set aside the judgment of the Trial Division and refer the matter back to the minister, “to re-assess the Appellant’s tax and interest in the total amount of $100,000.00 in accordance with the Amended Minutes of Settlement filed.”

The consent judgment sought from the Court of Appeal was, in effect, pursuant to a compromise settlement: it would have reduced the tax and interest owing by the taxpayer to a fixed amount that was less than the tax owing based on the application of the law to the facts as determined by the Federal Court Trial Division. The Federal Court of Appeal issued reasons, on April 22, 1974, expressing doubt as to whether it had the jurisdiction to grant the proposed judgment. The court’s primary concern, according to the reasons, was that the consent judgment fixed a single sum ($100,000) for both tax and interest, whereas the minister’s authority under the Act was to assess tax separately from interest and penalties. Second, the court was concerned that the assessment arising from the consent judgment would effectively fix an amount for interest prior to the payment of the tax, something beyond the statutory authority of the minister (and therefore beyond the authority of the court). Finally, as stated by the court, we must express a serious doubt as to whether the settlement agreement is an appropriate one for implementation by assessment at all. There are three possibilities as to the reason for the settlement, *viz*:

(a) the parties are in agreement that the correct tax payable on the facts as proved at trial is a certain amount . . .

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9 74 DTC 6247 (FCA).
10 72 DTC 6493 (FCTD).
11 Supra note 9, at 6248.
(b) the Minister in his wisdom is satisfied that there are compassionate grounds for remission . . . ; or

(c) the legal advisors of the Minister are satisfied that it is impractical to collect the amount payable under the present assessment and that more can be obtained under the compromise agreement than can be collected through legal process, in which event, the compromise is probably a proper subject matter for a compromise agreement made, in the exercise of the powers of the Attorney General of Canada to regulate and conduct litigation on behalf of the Crown, under the Department of Justice Act, RSC 1970, c. J-2.

This is clearly not a case where there should be a reduction in the amount of the tax in dispute. It is a case where the whole $200,500 was taxable or it was not. In those circumstances, we have grave doubt as to whether the Minister is legally entitled to reassess for a part of the amount of tax in question. If he is not legally entitled to do so, the Court cannot require him to do so.\(^\text{12}\)

The Federal Court of Appeal gave the parties 30 days to set a date for oral argument, failing which the application would stand dismissed. At the resulting hearing, the parties conceded that the judgment could not be granted as originally requested but sought to persuade the court that judgment could be granted which would accomplish what the parties had in mind. The court dismissed the application. In its reasons, the court expanded on the “grave doubt” expressed in its earlier reasons, stating that the minister has a statutory duty to assess the amount of tax payable on the basis of the facts as he finds them in accordance with the law as he understands it.\(^\text{13}\) It follows, according to the court, that the minister cannot assess for an amount designed to implement a compromise settlement; therefore, if a court refers an assessment back to the minister for reassessment, it must be for reassessment on the facts in accordance with the law and not to implement a compromise settlement. Similarly, a court cannot issue a consent judgment that the court itself could not have granted after a hearing of the appeal; in other words, a consent judgment must be in accordance with the Act and cannot implement a compromise settlement.

While Galway effectively precluded the court from implementing a compromise settlement, six years later the Federal Court of Appeal stated that any agreement by the minister to assess in a manner that is contrary to the proper application of the Act is an “illegal agreement” and does not bind the minister. In Cohen v. The Queen,\(^\text{14}\) the issue was whether a $105,608 gain realized from the sale of certain land in 1965 and 1966 should be treated as a capital gain, as contended by the appellant, or as business income from a venture, as contended by the Crown. The appellant had realized gains from the sale of other land in prior years (1961 to 1964), which the minister had treated as income. The appellant contended that he had agreed not to object to the assessments for the earlier years on the express understanding that

\(^{12}\) Ibid., at 6249-50.

\(^{13}\) In re Galway v. MNR, 74 DTC 6355, at 6357 (FCA).

\(^{14}\) 80 DTC 6250 (FCA).
the gain from the land sold in 1965 and 1966 would be treated as a capital gain. Needless to say, the minister assessed the gains arising in 1965 and 1966 as business income. The taxpayer appealed the reassessments to the Tax Review Board (not reported) and subsequently to the Federal Court Trial Division on two grounds: first, that the Crown was estopped from assessing the gains on income account owing to the previous agreement, particularly where the time had expired for the taxpayer to object to the reassessments of the earlier years; and second, that the gain was on capital account in any event. The Trial Division dismissed the taxpayer’s appeal.\textsuperscript{15} The court gave brief reasons for dismissing the first argument:

\begin{quote}
[I]t is not because the taxpayer has agreed as to the nature of a profit that there is less of an assessment than if he had not agreed. It is still taxation by statute, not by contract and it is the Act that governs, not any kind of arrangement, and in the present instance, the Minister had the right to reassess by virtue of [subsection 152(4)] of the Act, whatever arrangement may have been arrived at in 1967. I do not feel it necessary to review the cases on the subject matter of estoppel.\textsuperscript{16}
\end{quote}

The court went on to consider the substantive question and concluded that the gain was business income.

The taxpayer’s appeal to the Federal Court of Appeal was also dismissed.\textsuperscript{17} The court held that there was ample evidence supporting the trial judge’s conclusion that the gain was business income. It also rejected the taxpayer’s “estoppel” argument, holding that any agreement by the minister to assess tax otherwise than in accordance with the Act would be an “illegal agreement” and unenforceable against the minister.\textsuperscript{18}

The decisions in \textit{Galway} and \textit{Cohen} are both remarkably brief and include little analysis in support of the conclusions reached. Indeed, the only authority cited in \textit{Cohen} for the conclusion reached in that case is the earlier decision in \textit{Galway}. Both cases involved a dispute over the characterization of an amount received by the taxpayer: business income or a windfall in \textit{Galway}; or income gain or capital gain in \textit{Cohen}. But the circumstances of the settlement in the two cases are quite different. In \textit{Galway}, the Court of Appeal held that in such an “all-or-nothing” case, it is not possible to agree to a partial payment of tax. However, that is not what the minister did in the settlement reached in \textit{Cohen}. Rather, the minister purportedly agreed that a particular gain realized on a particular disposition was on capital account (and therefore not subject to tax at that time) in exchange for the taxpayer’s agreement not to dispute the characterization of gains realized on other dispositions of other property. The settlement thus supposedly reached in \textit{Cohen} was not a “compromise

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\textsuperscript{15} 78 DTC 6099 (FCTD).\textsuperscript{16} Ibid., at 6101.\textsuperscript{17} Supra note 14.\textsuperscript{18} Ibid., at 6251.
\end{flushleft}
settlement” as that term was used by the Court of Appeal in Galway; it was an agreement on the characterization of a particular amount for tax purposes where such characterization was in dispute. One characterization (business income) was perhaps much more likely than the other (capital gain); but either characterization was possible.

A third case, often referred to with Galway and Cohen, is the Supreme Court of Canada’s decision in Smerchanski et al. v. The Queen.19 The case concerned two taxpayers (an individual and a corporation controlled by the individual) who, threatened with criminal prosecution for tax evasion, agreed to waive their rights to appeal from reassessments of tax for the 1945 through 1959 taxation years. Prior to signing the waivers, the taxpayers committed in writing to pay whatever tax liability the Department of National Revenue determined was owing for those years “without question or reservation and without any demand whatsoever being made of the Department of National Revenue for particulars of the total amount involved.”20 The waivers signed by the taxpayers specified the amounts to be included in income in each of the years in dispute. The taxpayers subsequently objected to the reassessments issued on the basis that the waivers were obtained through undue influence. The Supreme Court of Canada concluded that there was no undue influence. In his judgment, Laskin CJ stated:

There could be no doubt in the present case of the taxpayer's liability to a large amount of tax even if there be some doubt in his mind that he owed all that the tax authorities claimed. There is no doubt of the enforceability of compromise agreements on liability for disputed debt as an escape from litigation, absent vitiating circumstances. I return then to the one factor that is said to make the waiver agreements herein voidable, and that is that the threat of prosecution lay behind them. . . .

The threat of prosecution underlies every tax return if a false statement is knowingly made in it and, indeed, this is inscribed on the face of the tax form. It cannot be that the tax authorities must proceed to prosecution when faced with a dispute on whether there is a wilful tax evasion rather than being amenable to a settlement, be it a compromise or an uncompromising agreement for payment of what is claimed. Here there was not even such a dispute but an acknowledgement of evasion and the taxpayer’s position cannot be stronger when he is a confessed evader than when he has disputed wilful evasion.21

Thus, it appears that a taxpayer is bound by a settlement if the taxpayer waives the right to object or appeal, absent duress or undue influence (or perhaps other wrongdoing) on the part of the tax authorities.22 In such cases, it is not the settlement per

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19 76 DTC 6247 (SCC).
20 Ibid., at 6250.
21 Ibid., at 6251 (emphasis added).
22 For a recent example of a case where a taxpayer’s appeal was quashed on motion by the Crown because of waivers filed by the taxpayer, see McGonagle v. The Queen, 2009 TCC 168, currently on appeal to the Federal Court of Appeal: court file nos. A-183-09 to A-186-09.
se that binds the taxpayer; rather, it is the fact that the taxpayer has waived the right of appeal from the reassessments issued pursuant to the terms of the settlement. This principle—that a taxpayer cannot appeal a reassessment in respect of an issue for which the right of objection or appeal has been waived by the taxpayer—has been enshrined in subsection 169(2.2) since 1995.23

Some of Laskin CJ’s comments in Smerchanski suggest that the minister in fact has the authority to make compromise settlements. He refers in his judgment to “a good deal of discretion reposed in the tax authorities as to enforcement of the Income Tax Act”;24 and, after referring to statutory provisions in both the United Kingdom and the United States giving the tax authorities the authority to make settlements rather than institute criminal proceedings, he states:

I do not regard these [UK and US statutory] provisions as necessarily pointing to the common law invalidity of all contractual settlements made in the knowledge of probable prosecution and in order to avoid it. Rather they represent an acknowledgement of practice by seeking to put beyond dispute the power of the tax collector to settle or compromise tax liability, even if there be wilful evasion leaving the taxpayer open to possible or probable prosecution.25

It may be inferred from this comment that a statutory provision specifically authorizing compromise settlements might be introduced for greater certainty, but that such authority is implied in the minister’s obligation under subsection 220(1) to “administer and enforce” the Act, or is perhaps expressly provided in the authority of the attorney general of Canada under section 5 of the Department of Justice Act to conduct all litigation for or against the Crown. After all, it would seem strange if the minister had the authority to make binding compromise settlements in order to permit a taxpayer to avoid criminal prosecution but had no authority to make compromise settlements where no criminal prosecution is contemplated or warranted.

Although Smerchanski was decided four years before Cohen, the Federal Court of Appeal in Cohen did not refer to the earlier Supreme Court decision. Bowman J has commented that the two cases are not “readily reconcilable,”26 and indeed are “inconsistent,”27 although he assumes that the Court of Appeal in Cohen must have been aware of the Smerchanski decision.28

23 Added by SC 1995, c. 21, section 71(1), applicable after June 22, 1995 (the date of royal assent) to waivers signed at any time.
24 Supra note 19, at 6252.
25 Ibid.
26 Mindszenthy v. The Queen, [1993] 2 CTC 2648, at 2650 (TCC).
27 Consoltex Inc. v. The Queen, 97 DTC 724, at 731 (TCC).
28 Ibid.
Evolution of the Jurisprudence Since Galway and Cohen

Probably the most outspoken judicial critic of the decisions in *Galway* and *Cohen* has been the former chief justice of the Tax Court. Bowman J’s lengthiest, but by no means only, consideration of the impact of *Cohen* was his decision in *Consoltex Inc. v. The Queen*. In *Consoltex*, the minister had assessed the taxpayer for the 1985 through 1988 taxation years on the basis that a certain percentage of the taxpayer’s net expenditures qualified as scientific research and experimental development. The percentage was agreed upon at a meeting in January 1992 involving representatives of the taxpayer, the taxpayer’s auditors (Price Waterhouse), and the Department of National Revenue. The taxpayer appealed from assessments based on the settlement. In contrast to the facts in *Smerchanski*, the taxpayer did not file any waiver of its right of appeal. At the Tax Court, the Crown argued as a preliminary matter that the taxpayer was barred from pursuing the appeals because it was bound by the agreement entered into with the minister. In his decision on this preliminary point, Bowman J found that the minister had accepted and agreed to the settlement with the taxpayer but, on the basis of *Cohen*, the minister was free to repudiate any such agreement even if the taxpayer had relied upon it to his detriment. According to Bowman J, the taxpayer was equally free to repudiate such an agreement.

In this respect, after reviewing the *Smerchanski* decision, Bowman J stated:

> I do not think that the *Smerchanski* and *Cohen* cases, read together, can be taken to justify a conclusion that the taxpayer is bound by a settlement agreement but the Minister is not. It is unconscionable enough that the Minister should be able to renege on settlements that he or she has made. It would be doubly indefensible that a taxpayer should be unilaterally bound to honour agreements that the Minister is free to repudiate. Neither the Minister nor the appellant is bound by the agreement of January 15, 1992. Of course the Minister acted on the agreement by assessing in accordance with it, but this does not distinguish the case from *Cohen*, because Mr. Cohen as well implemented the agreement by refraining from objecting to the first assessment. There are three possible alternative and inconsistent results of the *Cohen*, *Galway* and *Smerchanski* decisions: (a) the taxpayer and the Minister are both bound by such agreements; (b) neither is bound; and (c) the taxpayer is bound but the Minister is not. Assuming that *Cohen* is correct in law, so that (a) cannot apply, the least unacceptable result of the two remaining alternatives is (b).

Bowman J also found in favour of the taxpayer on the substantive issues. The Crown did not appeal the decision.

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29 Ibid. Bowman J also commented on the two decisions in *Mindszenty*, supra note 26; in *Harvey v. The Queen*, 94 DTC 1910, at paragraph 28 (TCC) (“And I observe that it follows as a corollary that where the taxpayer agrees with the Minister in a private deal like that [in *Galway*] the taxpayer should not be bound either”); in *Wiens v. The Queen*, 2003 TCC 491; in *Andrews v. The Queen*, 2005 DTC 1546 (TCC); and in *Garber*, infra notes 34 and 35.

30 Supra note 27, at 732.
In Enterac Property Corporation v. The Queen, the Crown was unsuccessful in the Tax Court in a motion to strike from the taxpayer’s notice of appeal allegations that the minister had entered into a binding agreement as to how the taxpayer would be assessed. In brief reasons from the bench, the Federal Court of Appeal (per McDonald JA) dismissed the Crown’s appeal. According to the court, it was not “obvious” that such an agreement was irrelevant:

Should it be determined on the evidence that the alleged agreement was within the power of the Minister to make, and providing its agent was acting within the scope of his or her authority and in accordance with the law, the Minister might be bound by the agreement.

Besides, according to the court, if the matter did proceed to trial, counsel could ask the court to revisit the jurisprudence in Cohen in light of the Consoltex and Smerchan-ski decisions. Unfortunately, the case never proceeded to trial (let alone to appeal) but was presumably settled on some basis.

More recently, in Garber et al. v. The Queen, both the Tax Court and the Federal Court of Appeal held that the Department of Justice had effectively repudiated a settlement reached by the CRA where the taxpayers accepted the repudiation and continued to negotiate for almost 11 years before moving to strike the minister’s reply to their appeals. The taxpayers in this case were a representative group of over 600 taxpayers that were involved in a charter boat tax shelter. The appeals commenced in 1991. In 1994, a settlement agreement was reached with the minister, which was quickly repudiated by Justice because of a concern that the Crown’s position in criminal proceedings against the promoters of the tax shelter (not the taxpayers) might be compromised by the settlement reached. Counsel for the taxpayers apparently accepted the repudiation and continued to try to settle the tax dispute. In 1996, Crown counsel made a new settlement offer, which many of the participants in the tax shelter (although not the taxpayers in this case) accepted. The taxpayers’ appeals slowly proceeded. During the 11-year period from 1994 to 2005, settlement negotiations evidently continued but broke down in early 2005. The Crown completed its undertakings, and in 2005, it indicated to the Tax Court that it was ready to set the matter down for hearing. The taxpayers brought a motion to the Tax Court for an order striking the minister’s reply and permitting their appeals to go forward uncontested on various grounds—particularly, that the minister had abused the court’s process and had caused undue delay in the hearing of the appeals. The alleged

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31 95 DTC 391 (TCC).
32 98 DTC 6202 (FCA).
33 Ibid., at 6203.
34 2005 DTC 1456 (TCC).
35 2006 DTC 6358 (FCA).
abuse arose primarily from the Crown’s repudiation of the settlement reached in 1994. Bowman J dismissed the taxpayers’ motion. Although he agreed that there was nothing illegal about the settlement agreement, he felt bound by Cohen:

[If [the Cohen decision] is taken as meaning that the Crown (and therefore the taxpayer) is never bound by any agreement to settle a case, whether legal or illegal, it runs counter to fundamental precepts of commercial morality. Here a carefully constructed settlement that is not contrary to the law and that took over two years of intense negotiation to conclude is, with a snap of the fingers, nullified. If it is the law that the Crown should never enter into agreements to settle tax litigation and that if it does it can renege on all settlements so that all tax disputes must be litigated in this Court, the system breaks down. Far more tax disputes are settled at the pre-assessment, objection and appeal level than are ever litigated.]

Bowman J held that it was within the authority of Justice to repudiate the agreement because it was an agreement made within the context of Crown litigation:

[T]he Department of Justice had the authority to repudiate the agreement. Whether it ought to have is a very different matter. If Cohen is right that the Crown can dishonour all agreements that it makes then there are no limits on the sort of extraneous considerations that the Crown can take into account when it decides to renege on an agreement. . . .

[What]ever I may think about the Crown’s behaviour in repudiating the agreement, it was legally, if not morally, entitled to do so and there is no sanction that this Court can impose. If the appellants wanted to have the validity of the settlement tested in Court they might have moved for judgment on the basis of the agreement or they might have brought an action in the Federal Court for some type of appropriate remedy. I am not deciding what they could have done. The fact is they seem to have accepted the Department of Justice’s repudiation of the agreement and gone back to the bargaining table.

With respect, Bowman J appears to expand the ratio in Cohen by suggesting that it permits the Crown to renege on agreements even if they are correct in law. In our view, the real stumbling block for the taxpayers in Garber was that they accepted the Crown’s repudiation of the agreement and continued to negotiate for approximately 11 years before challenging the repudiation. As Bowman J suggested, if the taxpayers wanted to test the validity of the settlement (or, more to the point, the validity of the repudiation), they should have brought an application to the Federal Court, presumably when the Crown originally repudiated the agreement.

The taxpayers’ appeal to the Federal Court of Appeal was dismissed. The court (per Sharlow JA) concluded that Bowman J “made no error of law in dismissing the
appellants’ motion, for the reasons he gave.” The court further commented on the scope of the minister’s discretion relating to the administration of the Act:

The record discloses that the Crown was motivated primarily by a concern that any settlement it reached with the appellants would have to be consistent with the factual allegations in the related criminal proceedings. We do not accept the argument of the appellants that this was an extraneous consideration. The criminal proceedings were related to the income tax appeals in this case, in the sense that they involved the same transactions. They also involved allegations that the accused individuals had defrauded all Canadian taxpayers. In our view, the Crown is entitled, when making a decision about the conduct of an income tax appeal in the Tax Court, to ensure that its position conforms to the Income Tax Act, and is consistent with the position taken by the Crown in related criminal proceedings. That is so whether the decision in question is made by the Minister or by the Department of Justice. We do not accept the argument of the appellants that the scope of the Minister’s discretion is narrower than that in relation to a decision made under subsection 169(3) of the Income Tax Act.

Apart from Sharlow JA’s one oblique reference to subsection 169(3), that provision was not considered by either the Tax Court or the Federal Court of Appeal. In terms of developing the jurisprudence regarding the legal and binding effect of settlements reached in the context of tax litigation, it is unfortunate that the taxpayers in this case did not challenge the repudiation in a more timely manner.

The decision in Garber should be contrasted with that in Oberoi v. The Queen. In Oberoi, the taxpayer brought a motion to the Tax Court to annul an out-of-court settlement signed by counsel for both parties and made pursuant to subsection 169(3). On February 17, 2005, five days before the hearing was scheduled to start, the taxpayer signed a mandate to his counsel authorizing him to settle the case in accordance with an offer made by Justice in a letter dated February 16, 2005. The settlement was finalized by counsel for the parties on February 21, 2005. A little more than one month later—that is, within approximately the same time frame of the Crown’s repudiation of the agreement in Garber—the taxpayer wrote a letter to Crown counsel repudiating the agreement on the basis that he had signed the mandate “under stress and great pressure from my lawyers.” The minister appears to have ignored (or disregarded) the taxpayer’s repudiation and, on April 7, 2005, issued reassessments in accordance with the terms of the subsection 169(3) agreement. On May 24, 2005, the taxpayer brought a motion to the Tax Court to have the agreement (and presumably the April 7, 2005 reassessments) set aside. Citing Smerchanski and concluding that there had been no coercion or fraud, Lamarre Proulx J denied the

38 Supra note 35, at paragraph 7.
39 Ibid., at paragraph 10 (emphasis added).
40 2006 DTC 3110 (TCC).
41 Ibid., at paragraph 22.
motion, concluding that the out-of-court settlement was enforceable. Lamarre Proulx J did not refer to Consoltex or Enterac in reaching her decision.\footnote{42}{Also not referred to in the judgment is subsection 165(1.2), which precludes the ability of a taxpayer to object to an assessment made under subsection 169(3).}

**Outstanding Issues**

It appears, then, that the court will not enforce against the minister a settlement that has no basis in law. Furthermore, it is questionable whether the minister has the authority to enter into a settlement agreement that has no basis in law. This will be the case whether the dispute is still at the internal appeals stage at the CRA or has proceeded to litigation. There is also some authority for the proposition that the minister (or Justice) can repudiate any settlement agreement concluded with the taxpayer, whether or not the agreement has a basis in law. Bowman J has suggested that Cohen stands for this proposition, but in the one case (Garber) in which he considered the Crown’s repudiation of what would otherwise be a “legal” settlement to be valid, the taxpayer had accepted the repudiation and only challenged it 11 years later.

In contrast, it appears that the taxpayer is bound by a settlement, at least in those cases where the taxpayer has waived the right to appeal or where the settlement is made under subsection 169(3). In both cases, the Act expressly precludes the taxpayer’s ability to object to assessments made in such circumstances.\footnote{43}{Subsection 165(1.2). As indicated in note 23, supra, and the accompanying text, subsection 169(2.2) also provides, “for greater certainty,” that a taxpayer cannot appeal to the Tax Court of Canada an assessment in respect of an issue for which the right of objection or appeal has been waived. Although there is no provision similar to subsection 169(2.2) with respect to assessments issued pursuant to subsection 169(3), the Federal Court of Appeal held in Transcanada Pipelines Limited v. The Queen, 2001 DTC 5625, that the taxpayer had no right of appeal in such cases.}

There are at least two important settlement issues that have not been considered by the court. First, is the minister bound by a settlement agreement concluded pursuant to subsection 169(3) if, for example, the minister refuses to issue reassessments in accordance with the terms of the agreement, or the minister repudiates the agreement and is challenged by the taxpayer (presumably through judicial review to the Federal Court) in a timely manner? Second, is a taxpayer bound by a settlement reached under subsection 169(3) or a settlement in which the taxpayer has waived the right of objection or appeal where the taxpayer challenges the settlement on the basis that it is not principled and is therefore “illegal”?

These unresolved cases illustrate the “Catch-22” associated with tax settlements, as indicated by Bowman J in Consoltex:

The basis upon which most income tax disputes are settled is that there may be some doubt concerning the result. If the only “legal” agreement is one that a court would ultimately sanction there would be no way in which the binding effect of such an agreement could be determined without litigation and this would defeat the purpose of settling, and the courts would be flooded.\footnote{44}{Supra note 27, at 731.}
The large number of cases that are settled, compared with the relatively few cases in which settlements have been challenged or repudiated, suggests that the settlement process in tax disputes “works.” However, as Campbell suggests in *Administration of Income Tax 2009*, the “principled basis” for settlement may be more honoured in its breach than in its observance:

In practice, [the settlement of an appeal in accordance with the Act] can often be man-aged or sidestepped by the parties agreeing to a disposition which, on its face, does not disclose any divergence from the result required by the Act. A dispute about the amount of a deduction, the valuation of a property or the amount of losses or profit from a business, for example, can be settled by agreement that the amount in question is a specified dollar amount, without further description or elaboration. Such an agree-ment in a joint consent to judgment will in practice be given effect by the Tax Court without further enquiry. Once entered in a judgment, the settlement will be binding and the enforceability of a settlement agreement will be irrelevant. Such a settlement cannot guarantee that the Minister will assess on the settlement basis in future years.\(^{45}\)

Perhaps more problematic than the “overt” subterfuge of consent judgments—which are presented to the Tax Court for approval and, on their face, must conform with the Act—is the “covert” subterfuge that may underlie settlements under subsection 169(3), or any pre-litigation settlements, which never see the light of day.

**SUBSECTION 220(1) AND MINISTERIAL DISCRETION**

Subsection 220(1) of the Act provides:

> The Minister shall administer and enforce this Act and the Commissioner of Revenue may exercise all the powers and perform the duties of the Minister under this Act.

The jurisprudence considering subsection 220(1), principally dealing with the minister’s discretion to issue binding advance income tax rulings, suggests that the minister is afforded little or no discretion in exercising powers granted under the Act.\(^{46}\) In *The Queen et al. v. Harris*,\(^{47}\) the Federal Court of Appeal considered the minister’s ability to issue a tax ruling that did not strictly conform to the provisions of the Act.

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\(^{45}\) Colin Campbell, *Administration of Income Tax 2009* (Toronto: Carswell, 2009), 549. See also ibid., at 28-29: “The result of this position taken by the courts has been that parties often resort to what in effect is subterfuge to present to the court a settlement, which is in fact based on a monetary compromise, as a settlement based on a principled application of the law.”

\(^{46}\) See also *Longley v. Canada (Revenue)*, 1992 CanLII 5961, at paragraph 19, where the British Columbia Court of Appeal (per Hutcheon JA) confirmed the proposition that “[t]he minister is bound to administer the *Income Tax Act* according to law,” and stated that he knew “of no legal grounds on which the minister could be directed by the court to act contrary to the law.”

\(^{47}\) Supra note 2.
The court (per Sexton JA) distinguished the powers of the minister under the Act with those of the UK’s commissioners of Inland Revenue:

In my view, [the House of Lords’ decision in IRC v. Federation of Self-Employed] can be distinguished on the basis that certain broad powers are afforded to Britain’s Inland Revenue Commissioners, which Revenue Canada does not have. In that case, Lord Wilberforce indicated the very wide discretion afforded to the Inland Revenue Commissioners to conclude compromise agreements with taxpayers. . . .

Lord Diplock confirmed Lord Wilberforce’s opinion by holding that income tax officials in Britain are vested with a “wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge the highest net return that is practicable having regard to the staff available to them and the cost of collection.” . . .

Revenue Canada is vested with no such powers. In Ludmer et al. v. The Queen, this Court held that the powers provided to the Commissioners which were at issue in the Federation of Self-Employed case are “fundamentally different” from the powers of the Minister in Canada:

Neither the Minister of National Revenue nor his employees have any discretion whatever in the way in which they must apply the Income Tax Act. They are required to follow it absolutely, just as taxpayers are also required to obey it as it stands. The institution of Commissioners equipped with broad powers and an extensive discretion to deal with particular cases does not exist here. Accordingly, it is not possible to judge their actions by varying and flexible criteria such as those required by the rules of natural justice. In determining whether their decisions are valid the question is not whether they exercised their powers properly or wrongfully, but whether they acted as the law governing them required them to act.

Similarly, this Court has held [in Galway and Cohen] that the Minister of National Revenue is limited to making decisions based solely on considerations arising from the Act itself.48

The UK statutory provision referred to in Harris is section 1 of the Taxes Management Act 1970,49 which provides:

Income tax . . . shall be under the care and management of the Commissioners of Inland Revenue.

The precursor of subsection 220(1) of the Act, section 22 of the Income War Tax Act, 1917,50 was closer in wording to the current UK provision:

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48 Ibid., at paragraphs 34-38 (notes omitted).
49 1970, c. 9 (UK).
50 SC 1917, c. 28.
The Minister shall have the administration of this Act, and the control and management of the collection of the taxation levied hereby, and of all matters incident thereto, and of the officers and persons employed in that service. The Minister may make any regulations necessary for carrying this Act into effect.

This provision remained substantially unchanged until it was replaced by subsection 105(1) in the 1948 version of the Act, the wording of which now appears in subsection 220(1). In the Senate debate on the bill that made these changes, Senator Hugessen commented:

The third objective to which the Senate Committee directed itself was the elimination of ministerial discretion. We heard a great deal of evidence and many representations against the wide discretionary powers conferred upon the Minister by many sections of the present Act. . . .

Honourable senators will find when they examine the Bill that the objective of the Senate Committee in this regard has been entirely met. Ministerial discretion has been also entirely eliminated. It has been retained in only a few minor instances relating to what I might call departmental mechanics. . . .

Generally speaking, I think we can state [that] the objections to the large discretionary powers conferred on the Minister by the present Act have been fully met in the present Bill, and to that [extent] the object of the Senate Committee has been achieved. In fact, the question has been raised whether this Bill does not go a little too far; whether, in an attempt to get away from ministerial discretion we have not sacrificed to some extent the flexibility which ministerial discretion has sometimes permitted, and thereby made the Act a little too rigid.51

It is likely that these comments were directed to the elimination of substantive ministerial discretion, such as the granting of capital cost allowance, rather than the discretion involved in more purely administrative matters, and it is unclear whether the change in wording was intended to affect matters such as the settlement of tax disputes.

The relevant UK statutory material also includes the Inland Revenue Regulation Act 1890, section 1(1) of which appoints commissioners of Inland Revenue “for the collection and management of inland revenue” and section 13(1) of which requires the commissioners to “collect and cause to be collected every part of inland revenue.” In IRC v. Federation of Self-Employed, Lord Scarman gave a somewhat more nuanced view of the responsibility of the commissioners than that which perhaps might be taken from the passages quoted in the Harris decision, stating that

I am persuaded that the modern case law recognises a legal duty owed by the Revenue to the general body of the taxpayers to treat taxpayers fairly, to use their discretionary powers so that, subject to the requirements of good management, discrimination between one group of taxpayers and another does not arise, to ensure that there are no favourites and no sacrificial victims. A duty has to be considered as one of several arising

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51 Canada, Senate, Debates, June 24, 1948.
within the complex comprised in the care and management of the tax, every part of which it is their duty, if they can, to collect.52

Notwithstanding the decision in *Harris* and the other authorities referenced therein, Canadian courts have been willing to allow the minister a degree of discretion in enforcing revenue statutes, balancing the statutory duty to enforce the Act with a realistic view of the factual context.

The decision in *Harris* contains no reference to the earlier decision of the Federal Court of Appeal in *The Queen et al. v. Optical Recording Laboratories Inc.*53 In that case, the taxpayer was assessed for part VIII tax under subsection 195(2) but was advised that Revenue Canada (the former name of the CRA) was prepared to modify or withhold its usual collection action with respect to the assessments if the taxpayer was able to satisfy Revenue Canada that its liability would be eliminated by the end of the year or had otherwise provided acceptable security. The taxpayer did not object to the assessment or provide security as requested by Revenue Canada. When Revenue Canada sought to collect the tax debt assessed, the taxpayer sought judicial review of the minister’s assessment and collection action. In granting the taxpayer’s request for judicial review, the Federal Court Trial Division described the minister’s offer to modify or withhold its normal collection policy as “wholly beyond the contemplation of the Income Tax Act” and noted that the Act “makes no procedural provision for contesting by litigation such an illegal irregularity.”54

The Federal Court of Appeal rejected this position. Commenting on the minister’s role in the collection of monies owing to the Crown, the court stated:

Subsection 220(1) requires the Minister to “administer and enforce [the] Act and control and supervise all persons employed to carry out or enforce [the] Act . . . .” Subsection 220(4) states that:

The Minister may, if he considers it advisable in a particular case, accept security for payment of any amount that is or may become payable under this Act.

The power which he is so given is to ensure that payment of the indebtedness by the debtor is ultimately secure. Normally the security provided would be monetary in nature. But the Minister’s power is not limited to the statutory power to take security of that nature. He is empowered, by virtue of his office, to manage his department, not exclusively from an administrative point of view but also from the point of view of what has in England been described as “management of taxes” which I take it means that as a credit [sic] he has the right to arrange payment for a tax indebtedness in such a manner that best ensures that the whole will ultimately be paid. For example, if insistence on payment in full when due might jeopardize the solvency of the taxpayer, with consequent loss of potential for payment in full, and if the taxpayer can continue in business by giving him time to pay, in his discretion the Minister might arrange for

52 [1981] 2 All ER 93, at 112 (HL).
53 90 DTC 6647 (FCA).
54 Optical Recording Corporation v. The Queen et al., 86 DTC 6465, at 6472 (FCTD).
payment in instalments with such security, if any, as he deems necessary. Effectively, such a course protects the Revenue, and, as well, the taxpayer’s solvency and continued ability to pay taxes. It applies too to the taxpayer satisfying the Minister in Part VIII tax situations that the taxpayer will eliminate its liability by year end. Such a course of conduct ought to be encouraged, not discouraged.\(^{55}\)

According to the court, “[s]uch a management discretion in making suitable collections arrangements undoubtedly exists under our Act and is not, as the Motions Judge found, illegal.”\(^{56}\)

This decision appears to contradict the position taken in the *Galway-Cohen-Harris* line of cases with respect to the scope of ministerial discretion under the Act. While *Optical Recording* deals with ministerial discretion in making collection arrangements rather than settlement of a reassessment, it considers the same statutory provision (subsection 220(1)), and its analysis, for example, of the justification for managing tax debt in order to maximize the eventual recovery by the fisc is precisely the same argument that is made with respect to the settlement of tax appeals.

*Distribution Canada Inc. v. MNR*\(^ {57}\) involved a group of independent grocers carrying on business in border communities, who had suffered business losses as a result of a policy of the minister not to collect customs duty on certain purchases made by Canadians in the United States, particularly short-term visitors. Under this policy, small amounts (one dollar or less) of duty were not collected and higher amounts owing were waived when priorities such as high traffic volumes or other concurrent enforcement activities dictated. The Customs Tariff then in force provided in part as follows:

Subject to this Act and the *Customs Act* and any regulation or order made thereunder, there shall be levied and collected on all goods enumerated or referred to in Schedule 1 or section 46 that are applicable to those goods. . . .\(^ {58}\)

In upholding the minister’s discretion to waive collection of amounts otherwise owing, the Federal Court of Appeal concluded that the minister “must take all reasonable means to enforce the provisions of the [Customs] Act” and that “[t]he reasonableness

\(^{55}\) Supra note 53, at 6653 (per Urie JA). Urie JA also quoted with approval the following comments made by Lord Roskill, in a different context, in *IRC v. Federation of Self-Employed*, supra note 52, at 119: “No question of any dispensing power is involved. The Revenue were in no way arrogating to themselves a right or inviting assumption of an arrogation to themselves of a right not to comply with their statutory obligations under the statutes to which I have referred. On the contrary, their whole case was that they had made a sensible arrangement in the overall performance of their statutory duties in connection with taxes management, an arrangement made in the best interests of everyone directly involved and, indeed, of persons indirectly involved, such as other taxpayers, for the agreement reached would be likely to lead ultimately to a greater collection of revenue than if the agreement had not been reached or ‘amnesty’ granted [emphasis added; notes omitted].”

\(^{56}\) Supra note 53, at 6654.

\(^{57}\) [1993] 2 FC 26 (FCA); leave to appeal dismissed [1993] 2 SCR vii.

\(^{58}\) RSC 1985, c. 41 (3d Supp.), section 19.
of those measures requires the assessment of policy considerations which are outside the domain of the courts since they deal with the manner in which the law ought to be enforced.\footnote{59}

The court further stated:

It must be said at the outset that one of the purposes of the \textit{Customs Tariff} is the collection of revenue. If the respondent finds that the cost of collecting duty and taxes from persons returning to Canada exceeds the amount collected, the Minister ought to have discretion so as to appropriately tailor the means to the end. If the enforcement of the Act leads to a depletion of revenues, the respondent cannot be said to be acting in conformity with the Act. In such cases, no more can reasonably be expected of him. . . .

The result, in my view, becomes obvious. Only he who is charged with such public duty can determine how to utilize his resources. This is not a case where the Minister has turned his back on his duties, or where negligence or bad faith has been demonstrated. It is a case where the Minister has established difficulties in implementation and where he enjoys a discretion with which the law will not interfere.\footnote{60}

The Federal Court of Appeal’s endorsement in \textit{Distribution Canada} of an approach that gives due weight to factors such as cost and difficulty of collection, limited facilities, and personnel resources in exercising an otherwise unqualified statutory requirement to collect customs duties, validates the consideration of factors such as costs or litigation risk in the settlement of income tax litigation.

The Federal Court Trial Division considered the duty of a minister to enforce legislation, albeit not revenue legislation, in \textit{Northern Lights Fitness Products Inc. v. The Queen}.\footnote{61} The applicant was a manufacturer and distributor of sports nutrition products subject to content and labelling restrictions under the Food and Drugs Act and the Food and Drug Regulations. The applicant complained that the ministers responsible (National Health and Welfare and Consumer and Corporate Affairs) were under a positive duty to perform inspection and enforcement functions and failed to perform that duty. In upholding the ministers’ response, the court applied a reasonableness test that took into consideration risk assessment and available resources, stating:

The Applicant submits that the Respondents are under a positive duty to perform inspection and enforcement functions by virtue of section A.01.022 of the Food and Drug Regulations which states:

\begin{quote}
An inspector shall perform the functions and duties and carry out the responsibilities of foods and drugs prescribed by the Act, and these Regulations. . . .
\end{quote}

The Respondents agree that they are under a duty to enforce the relevant legislation, but argue that the decision as to how and when this will occur is purely a matter

\footnote{59 Supra note 57, at paragraph 27 (FCA) (per Desjardins JA).}
\footnote{60 Ibid., at paragraphs 28 and 30.}
\footnote{61 [1994] FCJ no. 319.}
of policy. I agree with their position. The nature of the duty owed is to enforce the law, and only complete inaction in this respect may give rise to a judicial remedy. An important distinction must be drawn between requiring a government body to take some enforcement action, which the Court can do, and determining the manner of enforcement, which the Court cannot do. . . .

Upon reviewing the evidence presented, I must conclude that the Respondents have not been completely inactive with regard to the sport nutrition products market. Though it appears that relatively few resources have been dedicated to this sector, some “enforcement,” mostly in the form of compliance, has taken place. While I am sympathetic with the Applicant’s charge that the measures taken were not coercive enough, the effectiveness of these actions are [sic] matters beyond the jurisdiction of this Court. The choice of measures is discretionary in nature, within the bounds of reasonableness, and the exercise of this discretion is more appropriately questioned in the political forum where the Respondents are answerable.  

There are also numerous examples—including many published administrative concessions—where the minister (or, more specifically, the CRA) has expressly stated that the Act will not be enforced in circumstances where it clearly applies. Take but one example: taxable benefits to employees. The CRA has recently announced that, in order to “reduce or eliminate the administrative burden for employers and ensure more fairness in tax administration,” effective in 2010, non-cash gifts and non-cash awards to arm’s-length employees will not be taxable, regardless of their number, provided that their aggregate value is less than $500 annually. Separate non-cash long service or anniversary awards with a value of $500 or less may also qualify for non-taxable status, as well as gifts of nominal value. The CRA had previously stated that “employers will be able to give two non-cash gifts per year, on a tax-free basis, to employees for special occasions such as Christmas, Hanukkah, birthday, marriage or a similar event where the aggregate cost of the gifts to the employer is less than $500 per year.” There is no doubt that the fair market value of any such gifts is required to be included in an employee’s income under paragraph 6(1)(a). As a practical matter, however, the rationale for such concessions—to reduce the administrative burden on employers—is not in dispute.

**REFORM OF THE SETTLEMENT PROCESS**

In our view, the rationale for giving the minister express authority to settle tax disputes, including by way of compromise, is compelling. Given the problematic application of the “principled” basis for settlement, and inconsistencies in the jurisprudence that have not been resolved in almost 30 years, the solution now lies in legislative

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62 Ibid., at paragraphs 13, 16, and 22.


action, in the form of amendments to the Act, granting the minister express authority to settle tax cases on a compromise basis.

In *Principles of Canadian Income Tax Law*, Hogg, Magee, and Li make the case that

[the attitude of the Federal Court of Appeal in *Cohen* and *Gallway* is far too rigid and doctrinaire. If the Minister were really unable to make compromise settlements, he or she would be denied an essential tool of enforcement. The Minister must husband the CRA’s limited resources, and it is not realistic to require the Minister to insist on every last legal point, and to litigate every dispute to the bitter end. Most disputes about tax are simply disputes about money which are inherently capable of resolution by compromise. Presumably, the Minister would agree to a compromise settlement on the basis that it offered a better net recovery than would probably be achieved by continuance of the litigation. It seems foolish to require the Minister to incur the unnecessary costs of avoidable litigation in the name of an abstract statutory duty to apply the law. It seems obvious that the Act should be amended to give the Minister express authority to settle cases.]

65 The Report of the Technical Committee on Business Taxation suggested that there are “insufficient mechanisms in the tax system to allow [the CRA] to adopt a more commercial approach to the settlement of taxes owing. In some circumstances, allowing [the CRA] to accept less than the full amount of taxes owing would improve compliance by taxpayers and would increase collections by the government.”66 The report recommended that

settlement of disputes regarding taxpayers’ liability for tax be further encouraged by introducing a legislative mechanism that would authorize Revenue Canada, in appropriate circumstances, to enter into compromise arrangements on the basis of “risks of litigation.” The terms of any such compromise should be approved by senior officials.67

Statutory authority for compromise settlements is found in other jurisdictions. For example, in Ontario, section 109 of the Corporations Tax Act68 (applicable for taxation years ending prior to January 1, 2009) provides:

If any doubt or dispute arises as to the liability of a corporation to pay a tax or any portion of a tax demanded under the authority of this Act, or if owing to special circumstances it is deemed inequitable to demand payment of the whole amount imposed by this Act, the Minister may accept such amount as he or she deems proper.

67 Ibid., at 10.8.
This provision gives the Ontario minister express authority to enter into compromise settlements.

We have already noted the UK provisions and jurisprudence that grant the Board of Inland Revenue the discretion to balance its duty to collect tax imposed with prudent management of the revenue-collecting function, by taking into account various practical circumstances. The United States also follows the prudent management model of revenue collection. Under section 7121 of the Internal Revenue Code,69 the secretary of the Treasury is authorized to enter into settlement agreements with respect to the tax liability of any person, which agreements shall be “final and conclusive” and may not be reopened absent fraud or misrepresentation. Section 7122 of the Code authorizes the secretary to compromise any civil or criminal cases arising under the US internal revenue laws. Grounds for compromising a tax appeal include litigation risk (“doubt as to liability”), which exists “where there is a genuine dispute as to the existence or amount of the correct tax liability under the law”70, doubt as to collectibility, which exists “in any case where the taxpayer’s assets and income are less than the full amount of the liability”;71 or the promotion of “effective tax administration” where the secretary determines that “although collection in full could be achieved, collection of a full liability would cause the taxpayer economic hardship.”72 In addition to these grounds for settlement, the Internal Revenue Service is authorized to compromise a tax appeal where “due to exceptional circumstances, collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner.”73

It may be objected that granting additional discretion to the tax authorities to compromise tax disputes would introduce an unacceptable degree of inequity into the tax system because of the possibility that the discretion would be exercised on an inconsistent basis or, in some cases, not at all. A recent and prominent example of this type of inequity is the widely publicized settlement made by the CRA with former Prime Minister Brian Mulroney, as described in the proceedings of the Oliphant inquiry. It is evident that the Tax Services Office dealing with Mr. Mulroney’s file responded to his voluntary disclosures in a manner different than that of other offices.

There are several answers to the criticism that additional discretion could lead to inequity. The first is that no modern, complex government can operate without significant delegation of discretionary authority to government officials. The position of a revenue official faced with the decision of whether and on what basis to settle a tax dispute is no different from that of a police officer deciding what, if any, charges to lay; a public works official deciding which roads or sidewalks to repair;

69 Internal Revenue Code of 1986, as amended (herein referred to as “the Code”).
70 Treas. reg. section 301.7122-1(b)(1).
71 Treas. reg. section 301.7122-1(b)(2).
72 Treas. reg. section 301.7122-1(b)(3).
73 Treas. reg. section 301.7122-1(b)(3)(ii).
or, for that matter, a revenue official deciding whether to audit a particular taxpayer or group of taxpayers. Arguing that tax officials should have no discretion to settle tax disputes is like saying that they should have no discretion with respect to audits, so that, logically, all taxpayers should be audited if all are to be treated equally.

The second answer to the concern about inequity is that such discretion does not operate in an administrative or judicial vacuum. Tax officials are subject to supervision and direction by their superiors, to review and criticism by the auditor general, and, ultimately, to judicial review in the courts. With these safeguards in place, we trust public officials to make numerous other discretionary decisions. There is no reason why tax officials should not be allowed, subject to the same safeguards, to make discretionary decisions to settle tax disputes.

Finally, the elimination of discretion in pursuit of equity serves only to prove the truth of Voltaire’s remark that “the best is the enemy of the good.”74 The pursuit of perfection in an imperfect world often produces a more unsatisfactory situation than existed before the attempt was made. In this context, the pursuit of equity by denying discretionary authority to settle tax disputes has attached to it real costs borne by the parties to those disputes, both government and taxpayer. Perversely, the unrestrained pursuit of equity is more likely to result in equal costs, not equal benefit, and to restrict rather than improve access to justice.

Another objection to granting discretionary authority to settle tax disputes is that such authority would not be exercised at all. This objection is really a variant on the first, because it is highly unlikely that such discretion would never be exercised; rather, it would be exercised selectively. In any event, granting a discretion that is never exercised can produce no worse a result than having no discretion at all.

In our view, these objections are not sufficiently strong to alter our conclusion that it is time for the federal government to follow the British and American lead and propose to Parliament appropriate amendments to the Act, addressing the excessive circumscription of the minister’s administrative powers with respect to revenue collection. This could be effected through a legislative package that includes amending subsection 220(1) to authorize the minister to manage the revenue in a prudent fashion.75 The amended legislation might enumerate the factors, such as

74 “Le mieux est l’ennemi du bien,” Dictionnaire Philosophique (1764).

75 Additional legislative amendments may also be required. For example, section 171—which sets out the Tax Court of Canada’s powers to dispose of a tax appeal, and which has generally been interpreted strictly by the courts—should also be amended to specifically permit the court to grant a judgment on the consent of the parties. Such an amendment may be required to preclude any argument that it is beyond the Tax Court’s jurisdiction to issue a judgment that is not “correct” in law. The amendment would be limited to the circumstances of implementing a settlement reached by the parties (that is, a consent judgment). Although outside the scope of this article, any legislative amendments concerning settlements should also include a further amendment to section 171 specifically permitting the Tax Court to grant a pro tanto judgment (a judgment that disposes of part, but not all, of an appeal). There is currently much debate over whether the court has the jurisdiction to grant a pro tanto judgment, despite the fact that
cost, delay, or maximization of overall revenue collection, that could properly be taken into account by the minister, or it might be accompanied by appropriate explanatory notes to the same effect. Such a legislative amendment should effectively reverse the jurisprudence flowing from *Galway, Cohen*, and *Harris*.

An amendment such as the one we propose would not only enable the minister to make settlements on a prudent basis but also allow the minister to bind the CRA to advance tax rulings (which are not addressed in this article but are subject to similar considerations) and to create other estoppels against the Crown. In the alternative, the Act could be amended to add a specific power to make settlements (perhaps modelled on the US provisions discussed above). This would deal with the immediate problem of settlements but would leave outstanding other issues relating to ministerial discretion.

Section 170.1 of the TCC rules appears to contemplate such judgments. Pro tanto judgments would aid the settlement process in cases involving multiple issues. Where some, but not all, of the issues are settled (perhaps well in advance of hearing), the parties could apply to the court for a pro tanto judgment disposing of the settled issues, and thereafter the CRA could issue reassessments concerning the settled issues (even though all outstanding issues for the particular taxation year have not been resolved) and the parties could amend the pleadings to eliminate any reference to those issues.