DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

8 March 2013

THE RULE OF LAW IN CANADA

Judgment was handed down by Canada's Federal Court of Appeal on 21 February 2013 in the matter of *The Minister of National Revenue v RBC Life Insurance Company and Others.*

The judgment was delivered by Stratas JA, and offers a fascinating insight into the relationship between the Constitution, the Rule of Law and the powers granted to the Revenue Authorities.

The Minister of National Revenue had obtained four authorisations to require taxpayers to produce information and documents relating to some of their customers, who had purchased an insurance product that was described as '10-8 Insurance Plans'. After the Federal Court (court) had cancelled these authorisations, the minister appealed to the Federal Court of Appeals. The insurance companies then cross appealed, asking for a declaration by the court that ss231.2(3) should be of no force or effect because it infringed on the Canadian Charter of Rights and Freedoms. The minister argued that the provisions of the Income Tax Act did not allow for judicial discretion. Once the statutory conditions were established she argued that the court judge must not cancel the authorisations no matter how badly the Crown had acted in the matter.

The relevant section provides that on *Ex Parte* application by the minister, a judge on such conditions that he thought appropriate authorised the Minister to impose on the third party a requirement that a party verify his compliance by the person or persons in the identified group of its obligations under the Income Tax Act. An issue between the parties was that when the minister had approached a judge for the order, there was a significant amount of relevant evidence that had not been disclosed to the court. In the court's judgment they identified four categories of material facts:

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- The Department of Finance's refusal to amend the Income Tax Act to address the outdated provisions.
- Information that was contained in an advance income tax ruling request, which was relevant to determining whether there was compliance with the Act.
- The Canadian Revenue Agency's decision to send a message to the industry by refusing to answer the advance income tax ruling request and to take measures to chill the 10-8 business plans, in part by undertaking an 'audit blitz'.
- The Canadian Revenue Agency's Gaar committee had determined that the 10-8 plans likely complied with the letter of the Act if not the spirit.

Accordingly, the court had found that the minister failed to establish one of the two preconditions for such an order, namely that the authorisations were made to verify compliance with the Act. The court had accepted that the minister had a valid audit purpose, but this was extraneous to her primary goal which was to cool off the insurers 10-8 plan business, a business that the minister did not like on policy grounds.

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The minister appealed to the Federal Court of Appeals. In Canada the standard of review is that the court's findings on question of law must be correct, and unless an extricable question of law is present, its findings on questions of mixed law and fact could only be set aside on the basis of 'palpable and overriding error'. This was described by the court as a 'highly deferential standard of review'. The judge said in considering the Minister's submission there were three questions the court needed to consider:

- What the jurisdiction of the court on an Ex Parte application under s231.2(3) and on a review under s231.2(6) was.
- Had the minister made full and frank disclosure of relevant information in the Ex Parte application in the case?
- Did the minister's valid audit purpose save the authorisations?

The minister had argued that if the unnamed taxpayers were ascertainable and the purpose of the authorisation was to verify the unnamed taxpayer's compliance with the Act, the authorisation had to be granted and the reviewing judge could do nothing more. Stratas JA said that the plain wording of ss231.2(6) showed that the reviewing judge is free to go beyond the two statutory preconditions and exercise discretion whether the authorisation should be left in place. The judge said that judicial oversight pervaded the process, both at the initial *Ex Parte* stage and later if there was a review under sub s231.2(6). Judicial oversight was necessary because authorisations could intrude on third parties' privacy interests. When the minister was seeking an authorisation under ss231.2(3) the minister could not leave a judge in the dark on facts relevant to the exercise of his discretion, even if those facts were harmful to the minister's case (this is in paragraph 26 of the judgment). The judge said that the Minister had a high standard of good faith to make full disclosure so as to fully justify an *Ex Parte* order. He also pointed out that under this statutory scheme, the original judge must conduct the review, a judge who knows the original information submitted in support of the exercise of discretion in favour of granting the authorisation. For this reason he said that the review then must include a discretionary element and was not limited to only verifying that the two statutory preconditions had been met. He pointed out that based on the minister's interpretation, the authorising judge could be induced to grant an authorisation on the basis of bald lies but, on review, if the statutory conditions had been met, the same judge having discovered that she had been deceived, could do nothing about it (paragraph 29).

Stratas JA went on to say that a breach of the obligation to make full and frank disclosure of information relevant to the court's exercise of discretion on an *Ex Parte* application, could hinder the court's ability to act properly and judicially, and result in the making of orders that should not have been made, and that this was an abuse of process. He rejected the Minister's argument that the provisions constituted a complete code ousting the court's ability to redress such an abuse of process. There follows a discussion concerning the courts having an 'inherent' power independent of statute to redress abuse of process. At one time it was thought that the courts, as courts created by statute did not have inherent powers. But the judge referred to the case of *Canada (Human Rights Commission) v Canadian Liberty Net [1998] 1 SCR 626* at paragraphs 35 – 38 as confirming the existence of 'plenary powers' in the Federal courts, which were analogous to the inherent powers of Provincial Superior Courts.

In conclusion, the judge said it had been incumbent on the minister to demonstrate palpable and overriding error in the court's finding of relevance in the case. The minister had failed to do so.

Alastair Morphet

PROPOSED NEW TAX COURT RULES

In February 2013, the South African Revenue Service (SARS) released a draft of the anticipated new dispute resolution rules to be promulgated under s103 of the Tax Administration Act, No of 2011 (TAA), generally referred to as the Tax Court rules.

These rules are to replace the current rules that were promulgated under s107A of the Income Tax Act, No 58 of 1962.

Essentially, the rules prescribe the procedures to be followed in respect of objection and appeal proceedings against assessments or certain other administrative decisions by SARS. These decisions are listed under s104(2) of the TAA. The rules also deal with the procedures to be followed in respect of alternative dispute resolution, and various other issues relating to the Tax Court.

For the most part the proposed new rules are the same as the current rules, but there are a few noteworthy departures.

Certain time periods within which SARS must respond to a taxpayer have been shortened.

Where a taxpayer requests reasons for a decision, SARS currently has 60 days to provide such reasons, where adequate reasons have not been provided. Under the proposed rules, SARS only has 45 days to provide adequate reasons.

Also, under the current rules SARS must notify a taxpayer of the outcome of an objection within 90 days where SARS has not requested further information from the taxpayer. Under the proposed rules SARS will have to notify the taxpayer of the outcome of an objection within 60 days, where no further information was requested. However, SARS may extend the period by up to an additional 30 days where there are exceptional circumstances or the matter is complex.

The new rules also make provision for "test cases", which is a new concept introduced by s106(6) of the TAA. Where the determination of an objection or appeal is likely to be determinative of the issues involved in one or more other objections or appeals, SARS may designate the case as a 'test case'. The other objections or appeals may then be stayed. SARS must inform the taxpayers involved they may oppose the decision. Taxpayers whose objections or appeals have been stayed, may request a right of participation in the test case.

Probably the most radical departure from the current rules is that it is proposed that, once an appeal has been noted, the taxpayer must provide SARS with a 'statement of grounds of appeal' first, and then only does SARS have to deliver a 'statement of grounds of opposing appeal'. Under the current rules the obligation is on SARS to first provide the taxpayer with a 'statement of grounds of assessment', and then only does the taxpayer have to deliver a 'statement of grounds of appeal'.

It is submitted that this change will place the taxpayer at a severe disadvantage, as there will no longer be an opportunity for the taxpayer to understand exactly what SARS's case is in respect of an assessment. The taxpayer will now have to rely solely on SARS's reasons provided for the assessment, if any. In practice, SARS often provides inadequate reasons, or none at all, and when asked to provide reasons in terms of the rules, the response is either rather light, or completely dismissive. In light of the case of *CSARS v Sprigg Investment 117 CC 73 SATC 114*, it is unlikely that a taxpayer would get a detailed response from SARS when requesting reasons.

SARS has requested the public to comment on the proposed new rules by 22 March 2013.

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