CANADIAN TAX focus

Editor: Alan Macnaughton, University of Waterloo
(amacnaug@waterloo.ca)

Volume 3, Number 1, February 2013

Settlement Offers and Qualifying for Cost Awards

In cases heard under the TCC's general procedure (as opposed to the informal procedure), the winning party may receive more than the amount of taxes in dispute plus interest—that is, the court may award costs to the successful party, to be paid by the unsuccessful party. A rejected settlement offer made by the successful party is one factor that might increase the likelihood of such a costs award under both the current rules and the proposed rules, but recent case law suggests limitations on what types of offers qualify as settlement offers for this purpose.

Currently, the TCC has broad discretion and may consider several factors, including any written offer to settle the appeal (rule 147 of the Tax Court of Canada Rules (General Procedure)). However, proposed rule 147(3.1) (see practice note 18) proposes to further encourage settlement offers through the awarding-of-costs procedure by providing a very specific rule: a party who obtains a judgment as favourable as or more favourable than the settlement offer will be entitled (that is, as a matter of right rather than discretion) to receive such costs, and on the higher substantial indemnity basis (rather than on a party-and-party basis).

Regardless of which rule applies, a qualifying settlement offer must be clear and unequivocal, must be timely, must bring the dispute to an end, and must contain an element of compromise or incentive to accept (*Imperial Oil Resources Limited v. Canada (Attorney General)*, 2011 FC 652, and *McKenzie v. The Queen*, 2012 TCC 329).

Another requirement for qualifying offers is that the unsuccessful party must have been free, as a matter of law, to accept it. This issue arises because it is settled law that the Crown has a statutory duty to assess on a "principled" basis (*In re Galway v. MNR*, 74 DTC 6355 (FCA)). For example, if the question at issue is whether a taxpayer was grossly negligent in failing to report an amount, the Crown cannot accept a settlement offer that simply sets out an amount of tax to be paid. The principled basis of settlement and the all-or-nothing nature of gross negligence penalties require that the taxpayer satisfy the Crown that the taxpayer was not grossly negligent; otherwise, the matter will not be resolved before the appeal is heard.

The FC referred to the principled basis of settlement in *CIBC World Markets Inc. v. Canada* (2012 FCA 3). The taxpayer proposed to settle a GST appeal on the basis of 90 percent of the input tax credits in dispute. The court held that the taxpayer's entitlement to the input tax credits was an all-or-nothing question of statutory interpretation, and therefore the taxpayer had not made a qualifying offer. Similarly, in *Hine v. The Queen* (2012 TCC 295), the taxpayer proposed to resolve the appeal on the basis that the Crown waive a gross negligence penalty in exchange for the taxpayer agreeing not to seek any cost award. The TCC questioned whether the taxpayer's proposal contained any element of compromise and—although *Hine* did not involve a question of statutory interpretation—held that the Crown could not accept the taxpayer's proposal in this particular all-or-nothing appeal.

On the other hand, in *Potash Corporation of Saskatchewan Inc. v. The Queen* (2012 TCC 235), the taxpayer appealed an assessment denying the deduction of professional fees and offered to settle the appeal on the basis that the fees were eligible capital expenditures. The Crown argued that it could not accept the taxpayer's offer on a principled basis because the quantum of the expenses and whether the taxpayer had incurred them had not been determined until just before trial. The court stated that there was no legal impediment to accepting the offer (since this was a factual dispute); moreover, it is incumbent on the Crown to objectively consider whether the court would likely accept the unresolved facts and consider settlement offers in light of that analysis.

Peter Aprile
ATX Law, Toronto
paprile@atxlaw.ca

CTF CANADIAN TAX FOUNDATION
FCF FONDATION CANADIENNE DE FISCALITÉ