

Breakfast for Business

Best Practices for Accountants: Tax Dispute Resolutions

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Agenda

- The focus of today's seminar is to provide insights and strategies for accountants when handling and playing a role in tax disputes
- The areas to be covered by the seminar are:
 - 1) Introduction to Tax Disputes
 - a) Legal Disputes
 - b) Factual Disputes
 - 2) The Tax Dispute Process
 - 3) Best Practices at the Objection Stage
 - 4) Best Practices at the Appeals Stage

1) Introduction

- When a taxpayer disagrees with a determination made by the CRA, the taxpayer's recourse is generally to file an Objection and then, if no resolution is reached, to file an Appeal with the Tax Court of Canada
- The vast majority of tax disputes are resolved at either the objection stage or pre-hearing at the appeal stage
- The key to securing an early, cost-effective, and positive resolution is to focus on advancing the correct arguments and producing the necessary documents

1) Introduction

- In order to understand the argument and the documents required, the first step is to determine whether the dispute is a factual or a legal dispute (or a “status” dispute)
- The vast majority of disputes with CRA are fact based. The taxpayer asserts one state of affairs; CRA asserts a different state of affairs.

1) Introduction

- Reasons for the difference of opinion vary:
 - Lack of documentation
 - Misunderstanding of documentation
 - Different interpretation of ITA provisions (e.g. what is a “personal services business”? Are corporations “connected”?)
 - CRA “project”

1) Introduction: Legal Disputes

- Usually there is agreement between taxpayers, advisers and CRA over which provisions of the ITA apply, and how.
- However, a small number of disputes will focus on which provisions of the ITA apply, or on how (or whether) they apply.
- In many cases, the legal consequences of an agreed state of affairs are at issue – the proper interpretation of legal documents

1) Introduction: Legal Disputes

- Common areas of legal disputes:
 - Is an outstanding amount a loan or unpaid purchase price?
 - Is an amount receivable, payable, parked or uncollectible? (calculation of income)
 - Is an amount contingent? (status determination – tax shelter; calculation of ACB; deductibility)
 - Interpretation of share provisions (determination of control)
 - Interpretation of trusts

1) Introduction: Factual Disputes

- In many cases, CRA and the taxpayer disagree on the relevant facts. Once the facts are established, there is often agreement on how the law applies.
- Common examples:
 - Payments/receipts on account of capital or income
 - Real estate – capital gain or income, repairs or maintenance
 - Directed benefits vs. shareholder appropriations
 - “intention” cases – reps in tax shelters; “purpose test” situations (especially new ss. 55(2))

1) Introduction: “Status” Disputes

- Often involve questions of mixed fact and law:
 - Associated corporations
 - Control of corporation (impact of share provisions or USA)
 - Determination of arm’s length
 - Determination of residence
 - Eligibility for tax treaty relief
 - Benefits
 - What is the benefit? Does it exist? Is it quantifiable?
 - Who received it? (directed benefits)
 - In what capacity – employee, shareholder, trust beneficiary, other?
 - Interpretation of contracts and other legal documents

Why do we care about the difference?

- Could affect dealing with the auditor/proposal letter.
- Questions of fact – what documentary evidence do you have/need to prove the fundamental facts? What evidence needs to be prepared (for instance, evidence of taxpayer)?
- Questions of law – try to get auditor to refer the question to the Dept of Justice. In some TSO's there are embedded lawyers to assist in audits.
- Remember the auditors and Appeals Officers are not legally trained – they may not understand the legal consequences of documents or transactions

2) Overview of the Tax Dispute Process

- The first step in the tax dispute process is filing the Notice of Objection
- Once the Objection is filed, the matter will be assigned to an Appeals Officer
- Normally, the Officer will send a letter outlining the CRA's position and advising what further information or documents are required before the CRA will reconsider its position
- If the Appeals Officer cannot be persuaded, then a Confirmation or a Reassessment is issued

2) Overview of the Tax Dispute Process

- Within 90 days of the Confirmation or Reassessment, the taxpayer may then appeal to the Tax Court of Canada by filing a Notice of Appeal
- The Notice of Appeal is a brief document outlining the relevant facts, the applicable statutory provisions, and the reasons for the Appeal
- The Notice of Appeal is served on counsel with the Department of Justice, which represents the CRA (the Crown)
- The Crown then serves its Reply, which is a brief document outlining the Minister's position on the facts and the law

2) Overview of the Tax Dispute Process

- Once the pleadings have been served, the parties exchange their respective List of Documents
- The List of Documents is a book of all the relevant documents that the party may wish to rely on at the Hearing
- In rare instances, the parties will exchange a (Full) List of Documents, which is a book of every relevant document in each party's possession

2) Overview of the Tax Dispute Process

- After the documents have been exchanged, the parties conduct the examinations for discovery
- This is an opportunity to examine the other side under oath, in order to understand their position and obtain further information and documents
- The nominee for the Minister is normally the auditor or the Appeals Officer

2) Overview of the Tax Dispute Process

- After the parties are satisfied that they have obtained what they properly requested by way of the examination, the matter is then scheduled for a Hearing
- Where there are preliminary issues, the Court may hold a meeting before the Hearing
- At the Hearing, both sides introduce evidence via witnesses and make submissions to the Judge
- The Judge generally renders a decision within 1 – 4 months

2) Overview of the Tax Dispute Process

- It is important to note that the Tax Court of Canada has very different rules of evidence than other Courts in Canada
- First, the evidentiary burden rests with the taxpayer, instead of with the Crown
- The only exception to this is in regard to penalties and where the Crown is seeking an exemption as it is statute barred
- Second, the parties do not have to produce any document prior to the Hearing if they will be introducing it via cross-examination
- As a result, the Crown may appear at the Hearing with volumes of documents that counsel for the taxpayer had not previously seen

3) Best Practices at the Objection Stage

- **Determine your time horizon.**
- Ss.165(3) – Minister is required to “reconsider” the assessment, vacate, vary or confirm it, and notify the taxpayer “with all due dispatch”.
- This is “an elastic standard ... as long as the necessary review proceeds at a pace that is reasonable in the circumstances, the Minister will not be in default ...” *Imperial Oil* 2003 FCA 289
- Once the Notice of Objection is filed, it will often take months for it to be assigned, and for an Appeals Officer to contact you (notwithstanding CRA performance standards of resolving low and medium complexity objections within 180 days)

3) Best Practices at the Objection Stage

- However, the taxpayer can speed up the process. Para. 169(1)(b) allows a taxpayer to appeal to the Tax Court after 90 days have elapsed after service of the Notice of Objection.
- Advantages
 - Moves Appeal directly to Dept of Justice
 - No additional disclosure of information to CRA
 - Appeals Officer cannot raise alternative grounds for assessment
- Disadvantages
 - No informal access to auditor's report (Appeals Officer must provide it on request) – but you may already have (most of) the auditor's report in the proposal letter, and you can always request it under the ATIP.

3) Best Practices at the Objection Stage

- **Pro forma objection or fulsome objection?**
- May depend on time available to file Objection
- May depend on perception of value of the objection process
- You can always provide additional information to the Appeals Officer during the objection process – however, if that information was requested during the audit and was not provided, the Appeals Officer may have to send it back to the auditor, delaying the process
- The Notice of Appeal is not limited by the Notice of Objection

3) Best Practices at the Objection Stage

- **BE CAREFUL WHAT YOU SAY!**
- Statements and representations made at the objections stage cannot be withdrawn at a later stage.
- If you make a statement, challenge it – how can you prove it? What documents or other evidence supports the statement?
- Be careful in commenting on legal relationships and documents – there are fundamental differences between agents and trustees, partnerships and joint ventures, contractors and employees, shareholders and directors. A statement that misconstrues the relationship cannot be retracted, and becomes an admission.

Goal of the Objection Stage

- Vary or vacate assessment!
- Determine the assumptions the auditor used in making the assessment – these are the ones you must “demolish” if the case reaches Court
- Determine the facts the auditor relied on in making the assessment – so you can determine the case you have to meet in Court. Especially important if CRA is trying to open a statute barred year, or if penalties are an issue.

4) Best Practices at the Appeals Stage

- When commencing the Appeal, it is of critical importance that the Notice of Appeal is properly prepared
- All too often the Judge will commence the Hearing feeling frustrated with or leery of the taxpayer as the Notice of Appeal is unclear, vague, or missing required content
- Accountants play an important role in narrowing the issues, identifying the relevant statutory provisions, and defining the key facts

4) Best Practices at the Appeals Stage

- When drafting the Notice of Appeal, the taxpayer will need to consider what arguments should be given up
- Depending on various factors, the taxpayer may wish to limit the Appeal to one issue (e.g. penalties)
- Further, the taxpayer may wish to make an “in the alternative” argument (e.g. allow the expenses and the ITC or, in the alternative, only allow the expenses)
- The factors to be considered when deciding what to argue and what not to argue, include: i) the likelihood of the argument succeeding; and ii) the cost involved in order to persuade the Court

4) Best Practices at the Appeals Stage

- Accountants often play a key role in assessing what the cost will be in order to persuade the Court
- This is because a large portion of the cost is the fees that must be paid to the accountant to provide the factual analysis needed to advance the argument and to act as an expert at the Hearing
- It may be cost prohibitive to challenge all or a portion of a (Re)Assessment

4) Best Practices at the Appeals Stage

- After the pleadings have closed, the parties next need to prepare and serve their respective List of Documents
- Often, accountants have all of the documents that are required for the List of Documents
- As any dispute related document may eventually be produced, it is important that a clean original copy is preserved
- Any notes should be made on a photocopy of the documents
- It is also important to remember that any notes made by an accountant may not be subject to solicitor-client privilege

4) Best Practices at the Appeals Stage

- As such, accountants should be cautious about writing things like “there is no argument here” on any dispute related document
- As only the documents that the taxpayer intends to rely generally need to be produced, most harmful documents can remain hidden
- However, these harmful documents may come to light during the examination for discovery
- If there are harmful documents, it is important that these are discussed with counsel, under the umbrella of solicitor-client privilege

4) Best Practices at the Appeals Stage

- At the examination, the Crown will often have questions for the taxpayer which are aimed at the accountant
- When the Crown asks such questions, they are normally promised to be answered (known as undertakings), and then the accountant is given a chance to answer the questions in writing

4) Best Practices at the Appeals Stage

- As such, it is important that the accountant be ready and available to answer these questions
- The accountant should also take the time to review the transcript from the examination
- The taxpayer is able to correct any misstatements made during the examination and the accountant is often able to identify possible misstatements

4) Best Practices at the Appeals Stage

- Prior to the Hearing, the accountant will often be identified as an expert witness and be required to produce an expert report
- The expert report must meet the requirements defined by the Rules
- Unless there are any issues with the accountant's qualifications, the accountant is normally able to testify and the Court will often find their evidence to be helpful
- An accountant (as an expert) is unlike a normal witness, as they are able to testify about both facts and opinions

4) Best Practices at the Appeals Stage

- With the assistance of an accountant, most appeals are resolved prior to the Hearing
- The resolution process may involve a without prejudice meeting with the Crown, the taxpayer's counsel, the taxpayer, and the accountant, in order to flush out the relevant facts and arguments
- Accountants often play a critical role as they can quickly address questions and concerns regarding the tax consequences of potential resolutions

QUESTIONS?

Wilson Vukelich LLP can help with properly addressing and resolving your client's tax disputes. If you have any questions or require further information, please contact:

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