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Ministerial Assumptions and Burden of Proof in Tax Appeals

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THE CHANGING FACE OF MINISTERIAL ASSUMPTIONS

The role of ministerial assumptions in appeals under the provisions of the Income Tax Act[1] has evolved since the Supreme Court of Canada first articulated the rule in 1948 in *Johnston v. Minister of National Revenue*.[2] Nevertheless, the course of the evolution of the rule respecting ministerial assumptions has always been predicated on a concern for procedural fairness. As originally articulated in *Johnston* and subsequently in *MNR v. Pillsbury Holdings Ltd.*,[3] the rule permitted the minister to ground an assessment on assumptions of fact. Such assumptions were presumed to be true, leaving the taxpayer with three means of attack:

1. demonstrate that the assumption had not in fact been acted on;
2. demonstrate that the assumption was irrelevant; or

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1 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.

2 (1948), 3 DTC 1182 (SCC). For a review of the evolution of the rule and a general discussion of its operation, see William Innes and Hemamalini Moorthy, "Onus of Proof and Ministerial Assumptions: The Role and Evolution of Burden of Proof in Income Tax Appeals" (1998) vol. 46, no. 6 *Canadian Tax Journal* 1187-1211.

3 64 DTC 5184 (Ex. Ct.).

3. demolish the assumption[4]—that is, demonstrate that it was not in fact accurate.

As a judge and later chief justice of the Tax Court of Canada, Donald Bowman was one of the strongest advocates for using procedural fairness as a test for the evolution of the rules dealing with ministerial assumptions.

In *Continental Bank Leasing Corporation et al. v. The Queen*,[5] the appellant objected to an amendment of the Crown's reply that would add alternative factual allegations

4 As to the meaning of "demolish," see the decision of L'Heureux-Dubé J in *Hickman Motors Limited v. The Queen*, 97 DTC 5363, at 5377 (SCC):

> Where the Minister's assumptions have been "demolished" by the appellant, "*the onus shifts to the Minister to rebut the prima facie case*" made out by the appellant and to prove the assumptions: *Maglib Development Corp. v. The Queen*, 87 DTC 5012 (F.C.T.D.), at p. 5018. Hence, in the case at bar, the onus has shifted to the Minister to prove its assumptions that there are "two businesses" and "no income."
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> Where the burden has shifted to the Minister, and the Minister adduces no evidence whatsoever, the taxpayer is entitled to succeed: see for example *MacIsaac*, *supra*, where the Federal Court of Appeal set aside the judgment of the Trial Division, on the grounds that (at pp. 6381-2) the "evidence was not challenged or contradicted and no objection of any kind was taken thereto." [Emphasis in original.]

See also the decision of Bowman J in *The Cadillac Fairview Corporation Limited v. The Queen*, 97 DTC 405, at 407, footnote 2:

> The appellant pleaded that the payments were made pursuant to the guarantees and this allegation was denied. Counsel for the appellant argued that since the Minister had not pleaded that he "assumed" that the payments were not made pursuant to the guarantees the Minister had the onus of establishing that the payments were not made pursuant to the guarantees. The question is, if not a pure question of law, at least a mixed one of law and fact. In any event the basic assumption made on assessing was that the appellant was not entitled to the capital loss claimed and it was for the appellant to establish the several legal components entitling it to the deduction claimed. An inordinate amount of time is wasted in income tax appeals on questions of onus of proof and on chasing the will-o'-the-wisp of what the Minister may or may not have "assumed." I do not believe that *M.N.R. v. Pillsbury Holdings Ltd.* 64 DTC 5184 has completely turned the ordinary rules of practice and pleading on their head. The usual rule—and I see no reason why it should not apply in income tax appeals—is set out in Odgers' Principles of Pleading and Practice, 22nd edition at p. 532:
>
> > The "burden of proof" is the duty which lies on a party to establish his case. It will lie on A, whenever A must either call some evidence or have judgment given against him. As a rule (but not invariably) it lies upon the party who has in his pleading maintained the *affirmative* of the issue; for a *negative* is in general incapable of proof. *Ei incumbit probatio qui dicit, non qui negat*. The affirmative is generally, but not necessarily, maintained by the party who first raises the issue. Thus, the onus lies, as a rule, on the plaintiff to establish every fact which he has asserted in the statement of claim, and on the defendant to prove all facts which he has pleaded by way of confession and avoidance, such as fraud, performance, release, rescission, etc. [Emphasis in original.]

5 93 DTC 298 (TCC).

that were inconsistent with those pleaded as assumptions. Bowman J allowed the amendment:

> It is true that there are inconsistencies between the assumptions pleaded and the allegations in the paragraphs that the Minister now wishes to add. Had these paragraphs been included in the original reply those inconsistencies would not have justified striking the paragraphs. The respondent is not bound by the assumptions made on assessing. She is entitled, in support of the assessment, to allege new facts or facts that are inconsistent with those assumed on assessing, provided that she bears the onus of proving those facts. An assumption, in the sense in which the word has come to be used in income tax appeals, is not a binding admission.[6]

This approach recognizes that procedural fairness is a two-edged sword and that the Crown should not be prohibited from using alternative pleadings simply because it resorted in the first instance to the pleading of assumptions.

In *Mungovan v. The Queen*,[7] Bowman J dealt with a motion to strike out certain assumptions pleaded by the minister on the basis that they were scandalous, frivolous, and vexatious, and that they would delay a fair hearing. He concluded that such determinations were properly left to the trial judge rather than being dealt with on a preliminary motion:

> I think that we are seeing an evolution in the role of assumptions in income tax appeals. The day may be near when there will be a modification in the rigid rule that whatever the Crown may choose to say the Minister assumed has to be demolished by the taxpayer. It is well settled, for example, that the respondent cannot by dressing evidence up in the guise of assumptions expect the court to accept such evidence as proved. However a motion to strike out certain assumptions is not the place to reconsider the rule.
>
> It is entirely possible, as Mr. Mungovan points out, that some of the impugned assumptions are irrelevant. This is a matter for the trial judge to determine after the evidence has been presented. It is not a matter that can or should be determined on a preliminary motion to strike. It may well be that the paragraphs contain allegations that lie exclusively within the respondent's knowledge. It is a matter for the trial judge to determine whether the onus should be cast upon the respondent to establish them.[8]

This rule was reiterated by Bowman J in *Gould v. The Queen*:

> With respect, I am unable to ascribe to either the *Status-One* decision or the case which it followed, *The Queen v. Global Communications Limited*, 97 DTC 5194, the effect contended for by counsel for the appellant. A central component in the assessment which disallowed the charitable donations is the existence of a "scheme" in which it is alleged

6 Ibid., at 302.

7 2001 DTC 691 (TCC).

8 Ibid., at paragraphs 11 and 12.

> that the appellant participated and which enabled the participants to obtain what the Crown sees as artificial or inflated charitable tax credits. It of necessity involved third parties and if the existence of a scheme is essential to the Crown's case it should be able to plead and prove all of the components of the scheme. To say, as the appellant does, that *Global* and *Status-One* preclude any reference to third party transactions unless the appellant knows of or is privy to those transactions goes too far. If the existence of a scheme is germane to the disallowance it cannot be ignored whether or not the Minister assumed that the appellant knew about or was a party to the third party transactions that, according to the Reply, were an integral part of the scheme. If any of the facts assumed are truly within only the Crown's knowledge the Crown probably has the onus of proving them although this is ultimately for the trial judge to decide.[9]

In setting out the general principle that motions judges should normally leave procedural attacks on assumptions to the trial judge, Bowman J was essentially trying to discourage parties from using assumptions for procedural skirmishing rather than their substantive role of attempting to ensure a balance of procedural fairness in the trial of a tax appeal.[10]

Additionally, in *Jolly Farmer Products Inc. v. The Queen*, Bowman J considered the taxpayer's procedural motion to strike certain of the minister's assumptions and stated:

> [I]f the Minister bases an assessment upon an irrelevant fact an appellant may wish to argue that this in itself is a relevant fact in considering the correctness of the assessment. In other words, if an important basis of an assessment is an irrelevancy this may go a considerable way in casting doubt on the assessment itself. [11]

In his reasons for judgment in the main appeal,[12] Bowman J found that the minister's focus on two irrelevant facts, which he called "red herrings," was useful in determining the thinking that went into the making or confirming of the assessment. Once these "red herring" assumptions were determined to be irrelevant, it was clear that the appeal should be allowed.

Bowman J further explored the limits of assumptions in *Lau et al. v. The Queen*:

> Counsel for the appellants argued that the director's liability under section 323 of the *Excise Tax Act* is dependent upon a number of conditions being met, one of which is contained in paragraph 323(2)(c), that the Crown's claim be proved in the bankruptcy of the corporation within six months of the assignment in bankruptcy. Counsel contends that the Crown has failed to prove that this condition has been met. I agree that

9 2005 DTC 1311, at paragraph 21 (TCC). See also *Kossow v. The Queen*, 2008 TCC 422, at paragraphs 38 and 45.

10 See also the decision of Bowman J in *Holm et al. v. The Queen*, 2003 DTC 755 (TCC).

11 2008 DTC 2811, at paragraph 9 (TCC).

12 2008 TCC 409.

> the onus of proving this is on the Crown and the proof of claim did not find its way into the evidence. Nonetheless the notices of appeal state that the CCRA [Canada Customs and Revenue Agency, now the Canada Revenue Agency (CRA)] filed a proof of claim on February 7, 1997 and the replies admit the allegation except for the date. Moreover it is pleaded in both replies as an "assumption," so-called, that the Minister of National Revenue filed a proof of claim in the bankrupt estate of Nikiko on February 10, 1997. That assumption is unrebutted and the practice in this court, subject to certain exceptions, is that unrebutted assumptions pleaded in the reply must be taken as true.
>
> This point seems not to have been argued in *Wollitzer v. Canada*, [1995] T.C.J. No. 259, to which counsel referred.
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> I am reluctant to push the concept of "assumption" stated in *M.N.R. v. Pillsbury Holdings Ltd.*, 64 DTC 5184, any further than it has already been pushed. It gives the Crown a powerful advantage and is potentially capable of abuse. In light of my finding that Agatha was not a director and Patrick exercised due diligence and in light of the admitted statements in the notices of appeal I think it is preferable that I leave to another day the question whether the mere pleading of an assumption of a fact that is peculiarly within the respondent's knowledge and in respect of which the respondent has the onus of proof is sufficient to cast the onus on the appellant of disproving the assumption.[13]

This decision highlights, but does not find it necessary to answer, the question whether the minister can plead as an assumption a fact that is particularly within the minister's knowledge and not within the knowledge of the taxpayer—in this case, whether the minister filed a proof of claim in the bankruptcy of a corporation of which the appellants were directors. Bowman J's concern about the potential for abuse of such pleading is entirely consistent with the concept that assumptions have evolved as a means of ensuring procedural fairness to the minister and should not be utilized by the minister to, in effect, work a procedural unfairness upon appellants.[14]

In one of his last important decisions on the role of assumptions, *Anchor Pointe Energy Ltd. v. The Queen*,[15] Bowman J concluded that assumptions could be raised first at the point where the minister confirmed an assessment after the filing of a notice of objection but that such assumptions were not subject to the reverse onus. In other words, where the minister makes an assumption on the confirmation of an assessment, the minister bears the onus of proof in respect of that assumption:

> Quite apart from the compelling precedential force of four Supreme Court of Canada judgments there are additional reasons for not saddling the taxpayer with the onus of disproving new "assumptions" that the Minister has come up with at the objection level. It is a simple matter of procedural fairness. The cards are already stacked in favour of the Crown, with the presumption of correctness of assessments, the Crown's

13 2002 DTC 2212, at paragraphs 26-28 (TCC).

14 See also *Holm*, supra note 10, and *Redash Trading Inc. v. The Queen*, 2004 GTC 386 (TCC).

15 2006 DTC 3365 (TCC).

> right to plead unproved assumptions and the reverse onus of proof. I see no reason for stacking the cards any further by extending that reverse onus to "assumptions" made at the confirmation stage.[16]

Unfortunately, the Federal Court of Appeal rejected this finding:

> With respect, I disagree with this position. First, I do not think that the confirmation of Justice Rip's finding in paragraph 27 of his reasons in *Anchor Pointe Energy Ltd. v. Her Majesty The Queen*, 2002 DTC 2071 (T.C.C.) goes beyond an acknowledgment of the Crown's obligation to plead accurately its assumptions of fact. As previously mentioned, Rothstein, J.A. reiterated that assumptions of fact can be made at the confirmation stage of the assessment, but never addressed the issue of the onus of proof of these assumptions.
>
> Second, the position taken by the motions judge ignores the second meaning of assessment under section 152 to 177 of the Act, i.e., the product of the assessment as opposed to the process. Either at the initial or at the objection stage, the Minister is attempting to determine the tax liability, and quantum, of the taxpayer. He is entitled throughout this period, until his final determination, to rely upon facts newly discovered or revealed by the taxpayer, and assume them. Nothing in the meaning of assessment requires or permits that some facts be assumed by the Minister, others not, and that, as a result, two categories of assumptions of fact can be created with a different onus for each one. In my respectful view, this runs contrary to the rationale behind the onus of proof, especially in this case where the Minister would have to prove a negative, when all the evidence is in the hands of the taxpayer.[17]

With respect, the decision of the Federal Court of Appeal seems not entirely consistent with the underlying concern for procedural fairness that has led to the evolution of the rules governing ministerial assumptions. One can only hope that the court will revisit this area in the near future and give greater weight to the reasoning of Bowman J.[18]

BURDEN OF PROOF UNDER GAAR

In *Canada Trustco Mortgage Co. v. Canada*,[19] the Supreme Court of Canada specifically addressed the burden of proof applicable to the three elements of the general

16 Ibid., at paragraph 28.

17 *The Queen v. Anchor Pointe Energy Ltd.*, 2007 DTC 5379, at paragraphs 39-40 (FCA), per Létourneau J.

18 As a practical matter, this decision may tend to encourage more taxpayers to file an appeal pursuant to paragraph 169(1)(b) once 90 days have elapsed after the service of the notice of objection, since objections are almost never acted on during that period, thereby precluding the minister from forming new assumptions at that level. That would place the onus of proof on the minister in the case of any new assumptions formed after the date of filing of the notice of appeal. See, for example, *Wood v. The Queen*, 2008 DTC 2804 (TCC), appeal pending to the Federal Court of Appeal.

19 2005 DTC 5523 (SCC).

anti-avoidance rule (GAAR) in section 245 of the Act. On the first two elements—whether there is a "tax benefit" and, if so, whether there is an "avoidance transaction"—the taxpayer has the burden of disproving one or the other. These are factual issues, and the normal burden of proof in tax appeals should apply.[20] On the third element, however—whether, if there is a tax benefit and an avoidance transaction, there has been a "misuse" or "abuse" of the relevant statutory provisions under subsection 245(4)—the court determined that the burden of proof is on the Crown:

> The taxpayer, once he or she has shown compliance with the wording of a provision, should not be required to disprove that he or she has thereby violated the object, spirit or purpose of the provision. It is for the Minister who seeks to rely on the GAAR to identify the object, spirit or purpose of the provisions that are claimed to have been frustrated or defeated, when the provisions of the Act are interpreted in a textual, contextual and purposive manner. The Minister is in a better position than the taxpayer to make submissions on legislative intent with a view to interpreting the provisions harmoniously within the broader statutory scheme that is relevant to the transaction at issue.[21]

The logic of this conclusion may be questioned, on the basis of the court's own reasoning. In its analysis of subsection 245(4), the court states:

> The first task is to interpret the provisions giving rise to the tax benefit to determine their object, spirit and purpose. The next task is to determine whether the transaction falls within or frustrates that purpose. The overall inquiry thus involves a mixed question of fact and law. The textual, contextual and purposive interpretation of specific provisions of the *Income Tax Act* is essentially a question of law but the application of these provisions to the facts of a case is necessarily fact-intensive. . . .
>
> Once the provisions of the *Income Tax Act* are properly interpreted, it is a question of fact for the Tax Court judge whether the minister, in denying the tax benefit, has established abusive tax avoidance under s. 245(4). Provided the Tax Court judge has proceeded on a proper construction of the provisions of the Act and on findings supported by the evidence, appellate tribunals should not interfere, absent a palpable and overriding error.[22]

On the one hand, the court notes that determining the "object, spirit and purpose" of a provision that is alleged by the Crown to have been "misused" or "abused" is a question of law, and that determining whether what the taxpayer has done violates that "object, spirit and purpose" is essentially a question of fact.[23] It appears to follow

20 Ibid., at paragraph 63.

21 Ibid., at paragraph 65. See also the comments of LeBel J in *Placer Dome Canada Ltd. v. Minister of Finance (Ontario)*, 2006 DTC 6532, at 6537-38 (SCC).

22 *Canada Trustco*, supra note 19, at paragraphs 44 and 46. See also the summary in paragraph 66.

23 Ibid., at paragraph 55.

that since a burden of proof applies only to questions of fact, the only burden under subsection 245(4) should relate to the latter question. Yet the court appears to be merging the two questions into a single "mixed question of fact and law" without explaining why. The court justifies shifting the entire burden of proof under subsection 245(4) on the basis that "the Minister is in a better position than the taxpayer to make submissions on legislative intent";[24] but does this make legislative intent a question of fact? Once that intent has been determined, why should the Crown have the burden of establishing that it has been violated—which appears to be a pure question of fact?

The explanation may lie in the peculiar nature of the question of law involved in determining legislative intent and the unfairness of requiring a taxpayer, with limited resources available to do so, to show that that intent was not violated. One might take the position, as well, that a determination of the policy behind a provision of the Act that goes beyond its wording (where the wording is interpreted in accordance with acceptable modern principles of statutory interpretation) is not really a question of law, in the usual sense, or of fact, but is unique, justifying a special rule regarding burden of proof. As well, an argument can be made that, in considering the possible application of subsection 245(4), a court will not seek to determine the purpose of one or more provisions of the Act in the abstract but will only identify potential relevant provisions and what purposes may be relevant once the alleged abusive facts of the case are clear. Consequently, something may be said for treating what are analytically two separate issues in that subsection as being inextricably intertwined.

In summary, issues of fairness can be a justification for treating the issues under subsection 245(4) as a single question[25] and requiring the Crown to prove the elements that must be present for this aspect of GAAR to apply.

Even so, there appears to be an element of unfairness inherent in the court's reasoning. If matters relevant to determining the "object, spirit or purpose" of a provision of the Act that the taxpayer is alleged to have "misused" or "abused" are solely within the knowledge of the federal government, merely requiring the Crown to provide evidence of statutory purpose does not erase the unfairness to taxpayers who are trying to plan their affairs in accordance with the law, and totally undermines the need, stressed by the court at several points, for "certainty, predictability and fairness in tax law."[26] This analysis raises the important question of whether, in an appeal where subsection 245(4) is in issue, the court should admit evidence of internal communications within or between the Department of Finance and the CRA, or any other evidence of policy that is not publicly available, or rather should rely primarily on the context within the Act of the provisions in question and any other provisions of the Act that cast light on their purpose.

24 See the quoted text at note 21, supra.

25 "The abusive nature of the transaction must be clear": supra note 19, at paragraph 62.

26 Ibid., at paragraph 61.

Even where a court turned to explanatory notes provided by the Department of Finance that accompany proposed amendments to the Act, it would be applying, as law, documents created by the government that Parliament has not enacted. This practice would be particularly questionable since those notes are accompanied by the statement that "these notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe."

In fact, in denying the existence of "misuse" or "abuse" in *Canada Trustco* but upholding the application of GAAR in *Mathew v. Canada*,[27] the Supreme Court did not venture outside the context of the Act and its regulations.[28]

The statement by the Supreme Court[29] that a decision of the Tax Court of Canada on the question of "abuse" or "misuse" in a particular case should not generally be overturned presumes that such a decision is to be regarded as one of mixed law and fact, and is consistent with the Supreme Court's views as to the burden of proof on this question.

Unfortunately, the Supreme Court has not given much guidance to the Tax Court on how to discharge this difficult task, as is evident from the inconsistencies on this question in Tax Court decisions that have followed *Canada Trustco*. The Supreme Court in *Canada Trustco* contemplates a reference to "permissible extrinsic aids" in applying subsection 245(4),[30] without indicating what material outside the legislation itself may be referred to. At this point, particularly absent any clarification, this statement must be regarded as obiter dictum.

In *Evans v. The Queen*, Bowman J applied the direction given by the Supreme Court in *Canada Trustco* as a single question and concluded:

> The burden that is on the Minister to show that the object, spirit and purpose of the various provisions relied on have been defeated or frustrated has not been met. . . . The words "burden of proof" of which the Supreme Court of Canada speaks may imply an evidentiary burden but primarily they impose a requirement that the Crown identify the object, spirit or purpose of the relevant legislation that is said to be frustrated or defeated. This might be described as a "burden of persuasion" although this is not the usual sense of the expression "burden of proof." I think it would be premature for me to elaborate at any greater length on just how this burden can be met or what evidence should be adduced. This will need to be developed in future cases and in different fact situations. [31]

27 Sub nom. *Kaulius v. The Queen*, 2005 DTC 5538 (SCC).

28 Similarly, in upholding the application of GAAR in *Lipson et al. v. The Queen*, 2006 DTC 2687 (TCC); aff'd. 2007 DTC 5172 (FCA); aff'd. 2009 DTC 5015 (SCC). Bowman J confined himself to determining policy from a consideration of the provisions of the Act.

29 *Canada Trustco*, supra note 19, at paragraph 46.

30 Ibid., at paragraph 55.

31 2005 DTC 1762, at paragraph 35 (TCC).

Thus, it appears that the implications of the pronouncements of the Supreme Court of Canada on the question of burden of proof in GAAR cases will require further clarification as future cases are decided.[32]

32 In *Penn West Petroleum Ltd. v. The Queen*, 2007 DTC 715, at paragraph 47 (TCC), Bowman J rejected the argument that the "reverse onus" adopted by the Supreme Court in *Canada Trustco* should apply to impose a burden of proof on the Crown in cases involving specific anti-avoidance provisions, such as section 103 of the Act.