

Federal Court



Cour fédérale

**Date: 20130301**

**Docket: T-533-12**

**Citation: 2013 FC 96**

**Ottawa, Ontario, March 1, 2013**

**PRESENT: The Honourable Mr. Justice O'Keefe**

**BETWEEN:**

**CPNI INC.**

**Applicant**

**and**

**THE MINISTER OF NATIONAL REVENUE**

**Respondent**

**REASONS FOR JUDGMENT AND JUDGMENT**

[1] This is a judicial review of the Minister of National Revenue's (the Minister) decision to deny in part CPNI Inc.'s (the applicant or CPNI) request under subsection 220(3.1) of the *Income Tax Act*, RSC 1985, c 1 (5th Supp) (the Act) to cancel penalties and interest in respect of the 2008 and 2009 tax years.

[2] The applicant seeks an order requiring the Minister to review the application.

[3] Both the applicant and the respondent have asked for costs.

## **Background**

[4] The applicant is a Toronto corporation who requested taxpayer relief from interest for the years 2008, 2009 and 2010 on the basis of inability to pay. In its request, CPNI describes its financial results as losses of \$6,411,745 in 2008, \$5,211,187 in 2009 and \$1,663,451 in 2010. The amount of relief requested was \$116,000.

[5] The applicant described itself as developing a new product line targeted at the banking community. During the time period covered by the request, the applicant's target customers were negatively affected by the mortgage lending crisis in the United States. This resulted in large banks reducing spending and terminating new programs. This resulted in reluctance among external investors to commit funds to the technology sector and especially services aimed at the banking industry. During the covered period, the applicant accrued approximately \$690,000 in arrears to the Canada Revenue Agency (CRA) by failing to remit withholding taxes of employees.

[6] The applicant had since managed to pay a substantial portion of this amount. Of the remaining balance of approximately \$232,000, approximately \$116,000 was attributable to accrued interest and penalties. The applicant was then beginning to expand employment and required financing and requested the government's help in making progress. The applicant noted all of its revenues came from offshore accounts and created employment in Canada. The request was received on February 21, 2011.

## **First Decision**

[7] The first decision was made by the team leader (the decision maker) at the Taxpayer Relief Centre of the Expertise Appeals Branch on October 21, 2011. The decision only dealt with the 2008 and 2009 taxation years as no penalty or interest was charged for the 2010 taxation year.

[8] The decision maker set out the circumstances under which the CRA exercises its discretion to waive or cancel penalties and interest: (1) if the penalty or interest has resulted from extraordinary circumstances; (2) is due mainly to the actions of the CRA; or (3) there is an inability to pay. The decision maker noted the CRA may also grant relief requests not falling into any of these three categories.

[9] The decision maker noted that in applying the taxpayer relief provisions, the CRA will consider whether or not the taxpayer: (1) has a history of voluntary compliance with tax obligations; (2) knowingly allowed a balance to exist; (3) exercised a reasonable amount of care; and (4) acted quickly to remedy any delays or omissions.

[10] The decision maker then explained that after carefully considering the applicant's case, she had concluded it would not be appropriate to grant relief because a review had failed to show that the corporation was prevented from complying due to an inability to pay. This was based on three facts:

1. In 2010, there was a disposal of assets. Therefore, the applicant gave preference to other debtors over the CRA.

2. In 2010, the applicant acquired short term assets of \$3,225,261.
3. In 2009, there was a loan or advances due from related parties of \$3,054,790.

[11] The remainder of the decision dealt with arranging payment and explained that a second review could be requested.

[12] The certified tribunal record shows that a taxpayer relief fact sheet was filled out during the first decision and appears to be prepared by a subordinate of the team leader. This document showed an outstanding balance of \$54,601.77. The fact sheet repeated the grounds on which the applicant had requested relief and analyzed the factors listed above, noting that (1) not all remittances had been filed on time; (2) the taxpayer had knowingly allowed a balance to exist upon which arrears interest accrued; and (3) the taxpayer had been negligent or careless in conducting its affairs under the self-assessment system.

[13] The fact sheet also showed that there was no payment arrangement in place and that the following financial statements indicated there was no inability to pay. In 2009, there were current assets of \$3,225,261. In 2009, there was a disposal of assets of \$34,180 and in 2008, there were loans or advances due from related parties of \$3,054,790.

[14] The remainder of the fact sheet repeated the recommendation against relief for the reasons listed in the decision.

**Application for Review**

[15] The applicant requested a review in two letters dated October 21, 2011 and November 14, 2011.

[16] The first letter disputed the factual findings of the first decision. The applicant argued that it had not disposed of assets in 2010, but rather had depreciated its assets. The applicant noted it ran an operating deficit of \$1,658,106 for 2010 and had obtained funds from shareholders and a lender. It paid the CRA \$688,439. This was contrary to the decision's finding that the applicant acquired short term assets.

[17] The applicant disputed the decision's finding that there were advances due from a related party in 2009. The applicant submitted that there was no ability to realize funds from its inter-company account with its United States company as the amount referred to in the decision was in respect of accumulated losses over a number of years in that corporation, not accumulation of funds in the U.S. The applicant also complained that the CRA had not contacted CPNI to investigate this issue.

[18] The second letter dealt with procedural issues. It requested that the file be transferred to Summerside for review, since the team leader had signed off on the first decision, it would be difficult for a subordinate to question its validity. The applicant also complained of the duration of the review process and the resultant planning difficulties for the applicant. Finally, the applicant noted the most important fact in its request for relief was that it had lost \$14 million between 2008

and August 2011, a terrifyingly large amount of money for a small company and that the decision had made no reference to this fact.

### **Second Decision**

[19] This is the decision under review in this Court. In a letter from a manager at the Taxpayer Relief Centre for Expertise dated February 10, 2012, the second request for relief was granted in part.

[20] The manager explained that interest relief had been granted for the taxation years 2008, 2009, 2010, 2011 and 2012. However, the penalties charged were not cancelled.

[21] The manager noted consideration would not generally be given to cancelling a penalty based on inability to pay or financial hardship unless an extraordinary circumstance (such as flood or fire, civil disturbance, serious illness or accident or serious emotional distress) prevented compliance. The manager concluded that a review of the applicant's case did show an inability to comply with filing requirements based on factors beyond its control.

[22] There was also a taxpayer relief fact sheet for this decision, also prepared by someone other than the manager. It noted an outstanding balance of \$52,163.60. It summarized the facts provided by the applicant and listed the documentation provided. In considering the factors, it concluded that the taxpayer generally complied with tax obligations, but had knowingly allowed a balance to exist. The fact sheet indicated there had been some carelessness by the company, but that many credits

had been received and described the efforts by a company representative to work with the CRA to clear the balance.

[23] Under the ability to pay heading, the sheet noted an arrangement to pay the balance had been entered into. It also noted there was an inability to pay, as the company's total assets were \$10,378 and its total liabilities were \$14,333,887, along with shareholders' equity of \$22,745,109. The fact sheet indicated that the 2010 asset and the 2009 loan referred to in the first decision were in fact funds received from shareholders and lenders for operations and indicated the \$688,439 payment to the CRA. The fact sheet showed a liquidity ratio of 0.01285, when a ratio of 2.0 is generally considered sufficient for a company to meet short term needs. The debt ratio was 1,120.47, where a ratio over 1.0 is considered not solvent. The company had shown a deficit every year since 2005. The fact sheet also summarized correspondence between the applicant and the CRA.

[24] The fact sheet's recommendation was to cancel arrears interest from 2008 to 2012 due to the financial hardship reflected in the company's balance sheets. However, it also recommended not cancelling penalties as the company was not experiencing extreme financial difficulty as mentioned in IC07-1 Circular (IC07-1). Penalties may also be cancelled under extraordinary circumstances such as those described in the decision, but no such facts were present.

## **Issues**

[25] The applicant's memorandum raises the following issues:

1. Did the manager incorrectly conclude that the financial crisis did not qualify as a disaster?
2. Did the manager incorrectly conclude that the financial crisis did not qualify as an extraordinary circumstance?
3. Did the manager rely on personal rationalizations of the reasons for denying the penalty refund?
4. Did the manager incorrectly rely on failure to comply with filing requirements as grounds for denial?
5. Did the manager incorrectly transfer financial information from company submissions to CRA case records?
6. Did the manager fail to correctly parse the language of the regulations?

[26] I would rephrase the issues as follows:

1. What is the appropriate standard of review?
2. Did the manager err in refusing to relieve the applicant of penalties?

## **Relevant Policy**

[27] The applicant relies on three paragraphs from the CRA's Circular IC07-1:



### **Circumstances Where Relief From Penalty and Interest May Be Warranted**

23. The Minister may grant relief from the application of penalty and interest where the following types of situations exist and justify a taxpayer's inability to satisfy a tax obligation or requirement at issue:

- a. extraordinary circumstances
- b. actions of the CRA
- c. inability to pay or financial hardship.

...

### **Extraordinary Circumstances**

25. Penalties and interest may be waived or cancelled in whole or in part where they result from circumstances beyond a taxpayer's control. Extraordinary circumstances that may have prevented a taxpayer from making a payment when due, filing a return on time, or otherwise complying with an obligation under the Act include, but are not limited to, the following examples:

- a. natural or man-made disasters such as, flood or fire;
- b. civil disturbances or disruptions in services, such as a postal strike;
- c. a serious illness or accident; or
- d. serious emotional or mental distress,

### **Situations dans lesquelles un allègement des pénalités et des intérêts peut être justifié**

23. Le ministre peut accorder un allègement de l'application des pénalités et des intérêts lorsque les situations suivantes sont présentes et qu'elles justifient l'incapacité du contribuable à s'acquitter de l'obligation ou de l'exigence fiscale en cause :

- a. circonstances exceptionnelles;
- b. actions de l'ARC;
- c. incapacité de payer ou difficultés financières.

...

### **Circonstances exceptionnelles**

25. Les pénalités et les intérêts peuvent faire l'objet d'une renonciation ou d'une annulation, en tout ou en partie, lorsqu'ils découlent de circonstances indépendantes de la volonté du contribuable. Les circonstances exceptionnelles qui peuvent avoir empêché un contribuable d'effectuer un paiement lorsqu'il était dû, de produire une déclaration à temps ou de s'acquitter de toute autre obligation que lui impose la Loi sont les suivantes, sans être exhaustives :

- a. une catastrophe naturelle ou causée par l'homme, telle qu'une inondation ou un incendie;
- b. des troubles publics ou l'interruption de services, tels qu'une grève des postes;
- c. une maladie grave ou un accident grave;
- d. des troubles émotifs sévères ou une

such as death in the immediate family.

souffrance morale grave, tels qu'un décès dans la famille immédiate.

...

...

28. Consideration would not generally be given to cancelling a penalty based on an inability to pay or financial hardship unless an extraordinary circumstance, as described in 25 has prevented compliance. However, there may be exceptional situations that may give rise to cancelling penalties, in whole or in part. For example, when a business is experiencing extreme financial difficulty, and enforcement of such penalties would jeopardize the continuity of its operations, the jobs of the employees, and the welfare of the community as a whole, consideration may be given to providing relief of the penalties.

28. De façon générale, on ne considèrera pas l'annulation d'une pénalité en raison d'une incapacité de payer ou de difficultés financières à moins que des circonstances exceptionnelles, telles qu'elles sont décrites au paragraphe 25, aient empêché l'observation. Cependant, des situations exceptionnelles peuvent donner lieu à l'annulation totale ou partielle des pénalités. Par exemple, lorsqu'une entreprise a des difficultés financières extrêmes et que l'application des pénalités mettrait en danger la continuité de son exploitation, des emplois et du bien-être de la collectivité dans son ensemble, on peut considérer un allègement des pénalités.

### **Applicant's Written Submissions**

[28] The applicant argues the denial of the refund of penalties is not supported by the CRA's published policy. The applicant's arguments are chiefly concerned with the guidelines set out in IC07-1. The applicant argues that the manager failed to consider that the global financial crisis constituted a "man-made disaster" as contemplated in that circular. The applicant also argues that the financial crisis constitutes "extraordinary circumstances" under the same paragraph.

[29] In response to the decision's claim that penalties serve to encourage compliance with filing, withholding and remitting requirements, the applicant argues Parliament has seen fit to accommodate circumstances where encouragement is a useless exercise, such as during disasters.

[30] The applicant argues that the manager misconstrued the criteria in the circular as conjunctive instead of disjunctive; only one of the criteria need be met to qualify for relief.

[31] The applicant notes that the use of “however” in paragraph 28 of the circular indicates that what follows is an exception from the preceding text. The applicant points out that the financial crisis was not less of a disaster than a postal strike, as referred to in paragraph 25.

[32] The applicant notes it has created jobs which have created millions of dollars in payroll and other taxes.

[33] The applicant also makes further legal argument in the affidavit of its agent. While this is mostly repetitive of the arguments in the memorandum, the applicant notes that the fact sheet directly states the poor financial circumstances of the applicant, so it does not make sense for its application to be rejected.

### **Respondent’s Written Submissions**

[34] The respondent argues that reasonableness is the appropriate standard of review for the Minister’s decisions under subsection 220(3.1) of the *Income Tax Act*.

[35] The respondent argues the decision was reasonable in process and in outcome. The manager determined the applicant was not prevented in complying with any extraordinary circumstances and further determined that the applicant was not in an exceptional situation.

[36] The manager's review of the applicant's submissions confirmed that the applicant had an inability to pay the full amount owed. This was reflected in the decision that interest relief was warranted.

[37] The actions of the CRA and an applicant's history of compliance are both relevant factors in a taxpayer relief request.

[38] Circular IC07-1 is a guideline, not law. While it is helpful in the exercise of discretion, it does not impede that discretion.

[39] This Court has previously held that a real estate slump is not similar to the extraordinary circumstances discussed in the circular. This holding is equally applicable to a financial crisis.

[40] There is no evidence the applicant was in an exceptional situation as contemplated in paragraph 28 of IC07-1, as there was no evidence with respect to the applicant's employees and other stakeholders and how they would be affected by the enforcement of penalties. There was similarly no evidence with respect to how the community in which the applicant is located would be affected by the enforcement of penalties.

[41] Subsection 220(3.1) grants broad discretion to the Minister to allow relief or partial relief and in this case, it was properly exercised.

## **Analysis and Decision**

### **[42] Issue 1**

#### **What is the appropriate standard of review?**

Where previous jurisprudence has determined the standard of review applicable to a particular issue before the court, the reviewing court may adopt that standard (see *Dunsmuir v New Brunswick*, 2008 SCC 9, [2008] 1 SCR 190 at paragraph 57).

[43] The Court of Appeal has held that the exercise of discretion under subsection 220(3.1) of the Act is reviewed on a standard of reasonableness (see *Telfer v Canada (Revenue Agency)*, 2009 FCA 23 at paragraph 28, [2009] FCJ No 71).

[44] In reviewing the Minister's decision on the standard of reasonableness, the Court should not intervene unless the Minister came to a conclusion that is not transparent, justifiable and intelligible and within the range of acceptable outcomes based on the evidence before it (see *Dunsmuir* above, at paragraph 4). As the Supreme Court held in *Canada (Citizenship and Immigration) v. Khosa*, 2009 SCC 12, [2009] 1 SCR 339, it is not up to a reviewing court to substitute its own view of a preferable outcome, nor is it the function of the reviewing court to reweigh the evidence (at paragraph 59).

[45] **Issue 2**

Did the manager err in refusing to relieve the applicant of penalties?

The respondent is correct that guidelines are not legally binding on decision makers; however, in this case, I do not see any conflict between the guidelines and the decision so the analysis need not proceed any further than that.

[46] Paragraph 25 of IC07-1 clearly provides an elaboration on the term “extraordinary circumstances”, as the term is used in paragraph 23. The applicant’s position is that its circumstances fall within the meaning of that paragraph.

[47] First, I would note that the applicant’s argument that the financial crisis qualified as a “disaster” within the meaning of paragraph 25 was not made to the CRA. The applicant’s submissions mentioned the financial crisis as part of the explanation provided for inability to pay, but there was no sign the applicant was relying specifically on the analogy to a natural disaster and it certainly is not a self-evident argument. It would therefore be inappropriate for this Court to quash the decision on that basis, as the purpose of judicial review is to determine whether a reasonable decision was made based on the record before the original decision maker, irrespective of arguments raised after the fact.

[48] Ultimately, however, even if the CRA had turned its mind to the issue of the examples in paragraph 25 of IC07-1, it would have been reasonable to conclude that a financial crisis is not analogous to those examples. Mr. Justice Simon Noël previously concluded that a real estate slump

was not similar to those same examples in *Cooke v Canada (Attorney General)*, 2009 FC 1161 at paragraph 18, [2009] FCJ No 1586:

The applicant submits that the real estate slump in the 1990s is similar to extraordinary circumstances as discussed in the Guidelines, since it was an event beyond his control. The Court notes that we are not dealing here with an event comparable to the examples set out in paragraphs 5(a) and (b) of the Guidelines, such as flood, fire, civil disturbances or disruptions in services. The real estate slump was caused by a series of decisions made by businesspeople. It did not arise out of extraordinary circumstances such as the examples in the Guidelines. Of course, the circumstances were not intended by the businesspeople, but their decisions made the circumstances possible. The same thing could apply to the crash in the high-technology sector in the late 1990s and early 2000s.

[49] The final sentence makes clear that this analysis is not confined to a particular real estate slump, but to the peaks and valleys of the capitalist system generally and its inherent creative destruction. In a market economy, financial fluctuations are not extraordinary. The examples listed in paragraph 25 of IC07-1 are distinct from that concept. While I appreciate the applicant's point that a postal strike is closer to a financial disruption than a natural disaster, read in its whole, the meaning of paragraph 25 is clear that reduced demand from a particular sector is not "extraordinary" within its meaning.

[50] Of course, in IC07-1, paragraph 24 also makes clear that a request that does not fall into the criteria of paragraph 23 may still be granted, which is appropriate given the non-binding nature of the guideline. However, the applicant has not provided any reason why it should fall into this category and given the widespread effects of the financial crisis, it is not clear what sets this business apart from the economy generally.

[51] Turning to paragraph 28 of IC07-1, I agree with the applicant that it creates an exception to the extraordinary circumstances described in paragraph 25, as indicated by the use of “however”. I also agree with the applicant that the record shows that the CRA clearly acknowledged the financial difficulties suffered, as evidenced by the comment from the fact sheet that “[t]he company is in a grim financial situation”.

[52] Extreme financial difficulty, however, is not the only criterion mentioned in paragraph 28. Rather, the text makes clear that it is extreme financial difficulty in combination with the terms that follow:

. . . However, there may be exceptional situations that may give rise to cancelling penalties, in whole or in part. For example, when a business is experiencing extreme financial difficulty, and enforcement of such penalties would jeopardize the continuity of its operations, the jobs of the employees, and the welfare of the community as a whole, consideration may be given to providing relief of the penalties. [emphasis added]

[53] To properly apply paragraph 28, the decision maker must consider whether there is extreme financial difficulty in combination with the three following factors of continuity of operations, jobs of employees and welfare of the community.

[54] In this case, the applicant does not appear to have made any submissions on those three factors. While the letter of November 14, 2011 mentions jobs, no further detail is provided and most importantly, no link is drawn between the enforcement of penalties and the existence of jobs. Similarly, there is no mention of the continuity of operations (beyond the general claim of financial difficulty) or the welfare of the community.



[55] I appreciate the dire circumstances of the applicant, as confirmed by the CRA's own report. However, I see nothing in this decision which conflicts with intelligibility, justification or transparency or puts it outside the range of acceptable outcomes.

[56] Therefore, the application is dismissed.

[57] Both parties have asked for costs. Because of the nature of this application, the factual background of this case, including the financial position of the applicant and the applicant's efforts to pay the debt, I am not prepared to make an order of costs.

**JUDGMENT**

**THIS COURT'S JUDGMENT is that:**

1. The application for judicial review is dismissed.
2. There shall be no order as to costs.

“John A. O’Keefe”

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Judge

## ANNEX

**Relevant Statutory Provisions*****Income Tax Act, RSC 1985, c 1 (5th Supp)***

220. (3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

220. (3.1) Le ministre peut, au plus tard le jour qui suit de dix années civiles la fin de l'année d'imposition d'un contribuable ou de l'exercice d'une société de personnes ou sur demande du contribuable ou de la société de personnes faite au plus tard ce jour-là, renoncer à tout ou partie d'un montant de pénalité ou d'intérêts payable par ailleurs par le contribuable ou la société de personnes en application de la présente loi pour cette année d'imposition ou cet exercice, ou l'annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

**FEDERAL COURT**  
**SOLICITORS OF RECORD**

**DOCKET:** T-533-12

**STYLE OF CAUSE:** CPNI INC.  
- and -  
THE MINISTER OF NATIONAL REVENUE

**PLACE OF HEARING:** Toronto, Ontario

**DATE OF HEARING:** December 10, 2012

**REASONS FOR JUDGMENT  
AND JUDGMENT OF:** O'KEEFE J.

**DATED:** March 1, 2013

**APPEARANCES:**

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