

A Matter of Fairness: Cancellation of Interest and Penalties under the Canadian Taxpayer Relief Provisions

The authors, in this article, consider the application of the Canadian taxpayer relief provisions and the circumstances in which the Canada Revenue Agency may cancel interest and penalties levied under the Canadian Income Tax Act. The authors also address practical limitations on the ability to secure interest and penalty relief.

1. Introduction

Non-residents that invest, or carry on business, in Canada are frequently unaware of their Canadian tax filing and remittance responsibilities. Consequently, non-residents often fail to comply with their Canadian tax obligations, thereby giving rise to assessments of interest and penalties levied under the Income Tax Act (Canada) (the "ITA").¹

However, under certain circumstances, an assessment of interest or penalties may be unfair and arguably inappropriate. The Canadian federal government has acknowledged this reality by granting the Canada Revenue Agency (the CRA) the authority, under section 220(3.1) of the ITA, to cancel or waive penalties or interest levied under that Act.²

The discretionary authority of the CRA to grant interest and penalty relief is generally exercised in one of two ways. First, taxpayers that report their non-compliance voluntarily to the CRA may qualify for penalty and interest relief under the CRA's "Voluntary Disclosures Program". Second, interest and penalty relief may be requested by a taxpayer after the taxpayer has received notice from the CRA that penalties and interest may be owed. This article focuses on the latter circumstance, where a taxpayer wishes to seek relief outside the confines of the CRA's Voluntary Disclosures Program.³

2. Taxpayer Relief – An Overview

The CRA has developed guidelines to direct when its discretion to relieve taxpayers from interest or penalties assessed under the ITA should be exercised. Information Circular IC07-1 Taxpayer Relief Provisions (the "Guidelines")⁴ sets out certain circumstances under which the CRA may grant relief to a taxpayer from penalties or interest. Although the Guidelines do not have the force of law, they provide insight into the types of situations in which the CRA is prepared to provide interest or penalty relief.

Despite the breadth of the CRA's authority to grant penalty or interest relief, the CRA is frequently reluctant to provide such relief in practice. In most cases, a substantial burden is placed on a requesting taxpayer to justify the granting of interest or penalty relief.

3. Application for Relief

A non-resident taxpayer seeking relief from assessed interest or penalties must submit a written request explaining the relevant circumstances to the International Tax Services Office in Ottawa. In contrast, a Canadian-resident subsidiary of a non-resident taxpayer seeking such relief is directed to submit a similar request to the designated CRA intake centre responsible for the subsidiary's province or territory of residence.⁵ Written requests should be clearly identified as applications for "Taxpayer Relief". Alternatively, taxpayers may request relief by submitting a completed Form RC4288, Request For Taxpayer Relief.⁶

Since decisions to grant relief are based on a taxpayer's written submissions, it is important that taxpayers submit a complete written record, clearly outlining the relief being requested, the years for which relief is being sought and any pertinent details that the CRA officer reviewing the file requires to complete the review. Relevant documentary evidence should be submitted such as, depending on the circumstances, insurance statements, death certificates, or evidence of inaccurate CRA publications or advice.

In considering whether or not to grant a taxpayer's request for penalty or interest relief, the CRA may also consider other factors relating to the taxpayer's past behaviour and efforts to remedy mistakes. For instance, the

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1. CA: Income Tax Act (Canada), Natl. Legis. IBFD.
2. Analogous authority to grant relief exists under a variety of other federal and provincial statutes administered by the CRA.
3. For further information on the CRA's Voluntary Disclosures Program, see M. Friedman & A. Palmer, *An Overview of the Canada Revenue Agency's Voluntary Disclosures Program*, 30 Ests., Trust & Pens. J. 3 (2011), available at www.mcmillan.ca/Files/129669_Voluntary%20Disclosures%20Program.pdf.
4. CA: Income Tax Info. Circular IC07-1, *Taxpayer Relief Provisions* (31 May 2007), available at www.cra-arc.gc.ca/E/pub/tp/ic07-1/ic07-1-07e.pdf.
5. CA: *How to request taxpayer relief?*, available at www.cra-arc.gc.ca/gncy/prgrms_srvcs/txpyrllf/hw-eng.html.
6. CA: Form RC4288, *Request For Taxpayer Relief*, available at www.cra-arc.gc.ca/E/pub/tf/rc4288/rc4288-11c.pdf.

Guidelines indicate that the following factors may be considered by the CRA:

- a requesting taxpayer's history of compliance with tax obligations;
- whether or not a requesting taxpayer has knowingly allowed a balance to exist on which arrears interest has accrued;
- whether or not a requesting taxpayer has exercised a reasonable amount of care and has not been negligent or careless in conducting the taxpayer's affairs under the self-assessment system; and
- whether or not a requesting taxpayer has acted quickly to remedy any delay or omission.⁷

4. Situations Warranting Relief

4.1. Introductory remarks

Taxpayers unable to satisfy their tax obligations because of (1) extraordinary circumstances (*see* section 4.2.), (2) actions of the CRA (*see* section 4.3.) or (3) an inability to pay or financial hardship (*see* section 4.4.), have been identified as taxpayers deserving of special consideration for interest and penalty relief. The CRA also has residual discretion to grant relief in situations that do not fall into one of these three categories.

The Guidelines emphasize that applications for taxpayer relief are to be judged on their own merit and should not be used as a way to arbitrarily reduce or settle a tax debt. However, it may, nevertheless, be possible to negotiate some relief in settlement discussions over disputed assessments.⁸

4.2. Extraordinary circumstances

The CRA may consider granting penalty or interest relief when the circumstances giving rise to the taxpayer's non-compliance were beyond the taxpayer's control. In the Guidelines, the CRA identifies the following circumstances as a non-exhaustive list of extraordinary circumstances in which the CRA would consider granting relief:⁹

- natural or man-made disasters, such as flood or fire;
- civil disturbances or disruptions in services, such as a postal strike;
- a serious illness or accident; or
- serious emotional or mental distress, such as death in the immediate family.

The CRA occasionally issues press releases acknowledging that certain natural disasters could prevent a significant number of taxpayers from complying with their tax obligations. Notwithstanding such acknowledgements, taxpayers must generally still submit individual requests for relief, which are evaluated by the CRA on their own merits.

4.3. Actions of the CRA

The Guidelines also identify inappropriate or misleading CRA behaviour as a category of circumstances that could warrant relief from interest or penalties. The Guidelines include the following examples of CRA conduct that could give rise to relief:¹⁰

- processing delays that result in the taxpayer not being informed, within a reasonable time, that an amount was owed;
- errors in material available to the public, which led taxpayers to file returns or make payments based on incorrect information;
- incorrect information provided to a taxpayer, such as a case where the CRA wrongly advises a taxpayer that no instalment payments are required for the current year;
- errors in processing;
- delays in providing information, such as when a taxpayer could not make the appropriate instalment or arrears payments because the necessary information was not available; or
- undue delays in resolving an objection or an appeal, or in completing an audit.

4.4. Inability to pay or financial hardship

The CRA has shown a willingness to consider granting relief when a taxpayer has a demonstrated inability to pay the amounts owing or suffers financial hardship. For instance, the CRA may relieve a taxpayer of obligations to pay interest where:¹¹

- Collection has been suspended due to an inability to pay and substantial interest has accumulated or will accumulate on the outstanding balance.
- Due to a taxpayer's inability to pay a balance owing, the taxpayer has entered into an extended payment arrangement with the CRA. In such circumstances, the CRA may waive all or part of the interest for the period commencing when the arranged payments start until amounts owing are paid in full. Such relief would typically be limited to situations where the payments are made on time and the taxpayer has otherwise complied with its obligations under the ITA.
- The payment of the accumulated interest would cause a prolonged inability to provide basic necessities, such as food, medical help, transportation or shelter.

The CRA has, however, shown greater reluctance to grant relief simply because of a taxpayer's inability to pay or financial hardship. Exceptional circumstances that may warrant such relief could nonetheless arise, for example, when the viability of a business facing extreme financial difficulty would be jeopardized by the payment of such penalties, risking the continuity of its operations, the jobs of its employees and the welfare of the community as a whole.¹²

7. Guidelines, *supra* n. 4, at para. 33.

8. See, for example, CA: TCC, May 5, 2010, *Taylor v. Her Majesty the Queen*, 2010 TCC 246 (Tax Court of Canada decision, under appeal to the Federal Court of Appeal).

9. Guidelines, *supra* n. 4, at para. 25.

10. *Id.*, at para. 26.

11. *Id.*, at para. 27.

12. *Id.*, at para. 28.

5. Ten-Year Limit

The CRA's discretion to grant relief is limited under section 220(3.1) of the ITA to interest and penalties in respect of taxation years (or in the case of a partnership, fiscal periods of the partnership) that have ended within ten calendar years of the date of a request for relief (the "relief limitation period"). Accordingly, the CRA asserts that its discretion to grant relief for penalties or interest in respect of a taxpayer's application for relief filed during the 2011 calendar year is limited to penalties or interest in respect of taxation years (or fiscal periods of a partnership) ending during, or subsequent to, the 2001 calendar year.¹³ Recent jurisprudence has clarified that the CRA may cancel or waive interest accruing during the relief limitation period even in situations where the underlying tax debt or penalty on which interest accrued arose outside the relief limitation period.¹⁴

This time limitation may prove to be a significant hurdle for taxpayers seeking relief from longstanding tax debts or issues under appeal. Cases before the courts frequently do not reach final resolution before the relief limitation period has expired. Accordingly, taxpayers may wish to consider filing a request for relief prior to the expiration of the relief limitation period. In such circumstances, the CRA does not issue a decision as to whether it will exercise its discretion to provide interest or penalty relief until the objection or appeal is resolved or until all rights of appeal have expired.

6. Further Recourse

Taxpayers that are not satisfied with the outcome of a request for interest or penalty relief have limited recourse to certain other remedies. If a taxpayer feels the CRA's discretion in response to a relief request was improperly exercised, a taxpayer may submit a written request to have the decision reconsidered. On receiving such a request, a different CRA official reviews the relevant request after giving the taxpayer an opportunity to submit supplementary information.

A taxpayer that remains dissatisfied with the results of the CRA's second review may seek judicial review before the Federal Court of the decision rendered by the CRA. Under judicial review proceedings, a taxpayer must, in highly

simplified terms, demonstrate that the CRA exercised its discretion in an unreasonable or unfair manner in refusing its request. Where the Federal Court determines that the CRA's discretion was improperly exercised, it does not simply direct that the CRA exercise its discretion in favour of the taxpayer, but, instead, generally directs the CRA to reconsider its decision.

Taxpayers that remain dissatisfied after pursuing these remedies, or find themselves unable to obtain discretionary relief because the taxation periods in question are more than ten calendar years in the past, may also petition the federal cabinet for a remission order granting relief from obligations arising under the ITA.

Since the legal correctness of a penalty is a distinct issue from whether or not the penalty should be cancelled, taxpayers may also avail themselves of the ordinary appeal channels to challenge a penalty assessment. For instance, certain penalties levied under the ITA may be challenged at law on the basis that the taxpayer exercised due diligence. Similarly, a penalty for failing to file an information return may be challenged if a taxpayer can prove the return was, in fact, submitted before the applicable deadline. Taxpayers successfully demonstrating the inapplicability of such penalties should not generally need to rely on the discretionary remedies available under the CRA's taxpayer relief provisions.

7. Conclusions

Although the discretion granted to the CRA under section 220(3.1) of the ITA is quite broad, the CRA has typically exercised this discretion sparingly. Whilst the CRA has reserved some discretion to relieve taxpayers from interest and penalties beyond the circumstances described in the Guidelines, the CRA generally appears reluctant to grant discretionary relief except in exceptional circumstances.

13. *Id.*, at para. 13.

14. CA: FCA, June 2, 2011, *Bozzer v. Her Majesty the Queen*, 2011 FCA 186.