TAX COURT TAKES AIM AT THE BURDEN OF PROOF IN TAX APPEALS

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The Tax Court of Canada's recent decision in *Morrison v. The Queen*[1] is, at first blush, unremarkable: another case of a taxpayer who participated in a charitable gifting program and obtained a donation receipt for an amount much greater than any gift given. However, the decision is notable because it is the latest in a line of cases taking aim at the puzzling "burden of proof" that applies in tax appeals.

Generally, the burden of proof in civil cases is easy to understand. A plaintiff must list all the material facts that supposedly demonstrate the alleged legal liability of the defendant(s). Since the person who alleges a fact must prove it,[2] the plaintiff must present enough evidence to prove the listed facts on a balance of probabilities - the "more likely than not" standard. This is the plaintiff's burden of proof and, in civil cases in Canada, it is always on a balance of probabilities.[3]

However, in tax litigation in Canada, the burden of proof is much more complicated. This is unfortunate, since the size of Canada's *Income Tax Act*, the myriad of legal tax planning options available to taxpayers and the sometimes questionable positions of the Canada Revenue Agency ("CRA") already make tax litigation inherently complicated. The burden of proof is different in tax cases because of how the system deals with "assumptions of fact" the CRA makes in its assessments.

Canada has a self-assessing and self-reporting tax system. The CRA does not know every transaction that every taxpayer enters into the moment they enter it.[4] Rather, taxpayers know what their businesses do, know how much income they earn in a year, and know the source(s) of that income. This is why the *Income Tax Act* requires taxpayers to estimate the tax they owe and, in most cases, send a tax return (along with the balance owing, if any) to the CRA. During an audit, the CRA examines the return and has broad powers to gather information from or about the taxpayer. Based on this information, the CRA assumes certain facts about the taxpayer and/or his business to be true and can assess additional tax based on those assumptions.[5]

The burden of proof in tax litigation revolves around these assumptions, which the Crown must set out with specificity in its pleadings.[6] The Supreme Court of Canada set out the burden of proof in tax cases in *Hickman Motors Ltd. v. The Queen*[7] as follows: the taxpayer has the initial onus of demolishing the assumptions relied

on by the Crown by establishing a *prima facie* case. Where a *prima facie* case is established, the onus then shifts to the Crown to rebut the taxpayer's *prima facie* case by proving the CRA's assumptions on a balance of probabilities. Where the Crown fails to adduce sufficient evidence to do this, the taxpayer succeeds.

The interesting wrinkle in Morrison was that the taxpayer had no understanding of how the donation program actually worked. He had no idea what happened, in the words of the Court, "behind the curtain". In these circumstances, the taxpayer reasoned he should not bear the burden of proving he was entitled to the claimed donation credit. Instead, he argued that since the CRA knew about the program and made assumptions of fact about how it worked (or didn't work), the CRA should bear the burden to prove that the taxpayer was not entitled to the credit. Even though the Tax Court rejected this argument and mostly found against the taxpayer, the decision is helpful because of the Court's comments about the burden of proof.

In 2017, Justice Webb of the Federal Court of Appeal took aim at the burden of proof in tax cases in a concurring (not a majority) opinion in Sarmadi v. Canada.[8] In his reasons, he thoroughly examined and questioned the development of the shifting burden of proof. He pointed out that decisions holding that a *prima facie* case means something less than the balance of probabilities conflict with other Supreme Court of Canada decisions and that currently the burden may be lower on taxpayers in the Tax Court's Informal Procedure than in the General Procedure. Ultimately, Justice Webb described a shift in focus from the assumptions made by the CRA to the facts alleged by the taxpayer and denied by the Crown. In line with the general rule described above, the taxpayer would have the burden of proving the facts listed in its notice of appeal and denied by the Crown. The other two Justices in Sarmadi declined to adopt Justice Webb's reasons, but did call them "thoughtful, illuminating and attractive." They invited other litigants and the Tax Court to offer useful insights on the topic.

In Morrison, Justice Owen did just that. In his view, there is only one "persuasive burden" in tax litigation – that being on the taxpayer to demonstrate that the CRAs assessment is wrong – and that burden never shifts. Rather, where a taxpayer presents evidence to contradict CRAs assumptions on a balance of probabilities, the Crown has the "tactical burden" to decide to call evidence to support that the assumption is true. Ultimately, though Justice Own questioned the precedential value of the Hickman Motors shifting burden of proof, he recognized he was bound by higher court decisions applying it.

While admittedly esoteric, the issue of burden of proof in tax cases has a real impact in tax litigation. As early in 1996, Chief Justice Bowman (as he then was) of the Tax Court wrote that "[a]n 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'."[9] Indeed, there are dozens of Tax Court decisions about the meaning of "demolish" or of "*prima facie*". There are Tax Court decisions on what happens when the assumptions are exclusively in the knowledge of the CRA. There are decisions on when it would be difficult,

perhaps even impossible, for a taxpayer to gather evidence to raise a *prima facie* case and demolish assumptions. There are decisions about how many assumptions need to be demolished. There are decisions on how much evidence the Crown needs to marshal if the burden of proof is shifted to it. And, of course, there are appeals court decisions about the Tax Court decisions.

Each of these decisions represents time and money that taxpayers and the government have spent arguing about the minutiae of a tax appeal, rather than the merits. In an era where access to justice concerns and the ever-increasing costs of litigation are paramount, this shifting burden of proof, with different evidentiary thresholds at different stages, needlessly increases the complexity and expense of tax litigation.

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[1] 2018 TCC 220.
[2] *Ontario (Human Rights Commission) v. Simpsons Sears Ltd.*, [1985] 2 SCR 536 (SCC), at paragraph 28.
[3] *F.H. v. McDougall*, 2088 SCC 53.
[4] Although real-time tax reporting technology may be on the way.
[5] The CRA is also entitled to make assumptions of fact when considering a Notice of Objection filed by a taxpayer.
[6] *The Queen v. Anchor Pointe Energy Ltd.*, 2007 FCA 188.
[7] [1997] 2 SCR 336 (SCC) at paragraphs 25 to 95, applied recently in House v. The Queen, 2011 FCA 234 at paragraph 30.
[8] *Sarmadi v. Canada,* 2017 FCA 131.
[9] *Cadillac Fairview Corp. v. The Queen,* (1996) 97 DTC 405 (TCC) at page 407, aff'd (1999) 99 DTC 5121 (FCA).

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.