Supreme Court to consider tax court jurisdiction

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What you need to know

- On Feb. 23, 2023 and March 16, 2023, the Supreme Court of Canada (SCC) granted leave to appeal in two important cases considering the jurisdiction of the Tax Court of Canada (TCC): *Canada v Dow Chemical Canada ULC*, 2022 FCA 70 (Dow) and *Canada (Attorney General) v. Iris Technologies Inc*., 2022 FCA 101 (Iris). The Court confirmed that it will hear the appeals in Dow and Iris together.
- These appeals give the SCC the opportunity to assist taxpayers and practitioners in navigating the often complex and confusing jurisdictional conflicts between the TCC and the Federal Court (FC).

Background

Jurisdiction denotes a court's authority to render decisions on specific types of matters brought before it.

As a statutory court, the TCC derives its authority from Parliament and the *Tax Court of Canada Act* (R.S.C., 1985, c. T-2) (the Tax Court Act). The Tax Court Act provides that the TCC has the exclusive original jurisdiction to hear and determine references and appeals (*i.e*., no other court may hear an initial dispute with respect to) matters arising under the *Income Tax Act,* RSC 1985 c 1 (5th Supp) (the ITA), certain parts of the *Excise Tax Act,* RSC, 1985, c E-15 (the ETA), and other statutes, when such references and appeals are specifically provided for under the act from which the appeal arises. Both the ITA and ETA stipulate, in sections 169 and 302 respectively, that the TCC is the court to which taxpayers may appeal assessments arising under these acts. Therefore, it is generally within the exclusive original jurisdiction of the TCC to determine the validity of assessments under the ITA and ETA.

In contrast, the FC has exclusive original jurisdiction under the *Federal Courts Act,* RSC 1985, c F-17 to review and provide remedies for discretionary decisions of the Minister of National Revenue (the Minister).

The issue is in determining the boundaries between the actions and decisions of both the Minister and the Canada Revenue Agency (the CRA) reflected in an assessment, versus the validity of the assessment itself. The question of who has the appropriate

jurisdiction has given rise to persistent conflict in tax disputes in both courts and often leads to taxpayers initiating disputes in both courts in order to ensure they protect their rights.[1]

Questions before the SCC

In the Dow and Iris joint hearing, the SCC will consider whether the Federal Court of Appeal (FCA) was correct in holding:

1. that a review of the decision by the Minister to deny a requested downward transfer pricing adjustment under subsection 247(10) of the ITA, was a matter outside of the TCC's jurisdiction (Dow); and
2. that an application in the FC seeking declarations that:
    a. the taxpayer was denied procedural fairness in the audit and assessment process;
    b. there was no evidentiary foundation upon which an assessment could be issued under the ETA; and
    c. the assessments were issued for the improper purpose of depriving the FC of jurisdiction to hear administrative law grievances raised by the taxpayer in a related application, constituted a collateral challenge to the validity of assessments issued under the ETA, a matter within the exclusive jurisdiction of the TCC (Iris).

Dow: Facts and lower court decisions

In December 2011, the Minister reassessed Dow's 2006 taxation year to add approximately $307 million to its taxable income as a result of transfer pricing adjustments made under section 247 of the ITA in relation to intercompany transactions involving Dow and a Swiss operating company with whom Dow did not deal with at arm's length. Pursuant to subsection 247(10) of the ITA, the Minister has the discretionary power to adjust the value of a non-arm's length transaction downward (therefore reducing the taxpayer's assessment). The Minister denied Dow's request to apply an offsetting downward transfer pricing adjustment in respect of the interest expense taken on the same loan amounts for the years which would have reduced Dow's taxable income for the year.

Dow appealed the resulting assessment to the TCC. In advance of the hearing of the appeal, the parties submitted a question to the TCC under Rule 58 of the *Tax Court of Canada Rules (General Procedure),* SOR/90-688a. Rule 58 allows the TCC to consider a legal question where there are no relevant facts in dispute and where the determination of the question has the potential to dispose of all or part of the appeal, substantially shorten the hearing, or a substantially reduce costs. The Rule 58 application question before the TCC was:

> Where the Minister of National Revenue has exercised her discretion pursuant to subsection 247(10) of the Income Tax Act (ITA) to deny a taxpayer's request for a downward transfer pricing adjustment, is that a decision falling outside the exclusive original jurisdiction granted to the Tax Court of Canada under section 12 of the Tax Court of Canada Act and section 171 of the ITA?

Based on available caselaw related to matters arising under the predecessor to the ITA (the *Income Tax War Act,* RSC 1927 c 97) and the *Employment Insurance Act,* SC 1996, c 1996, the TCC determined that the Minister's decision to deny a taxpayer's request for a downward transfer pricing adjustment is within the TCC's exclusive original jurisdiction provided that the assessment resulting from that decision has been properly appealed to the TCC. The TCC's decision was based primarily on a determination that in such a case, the decision of the Minister must be made before any assessment of a taxpayer's taxes can be made and must be made in accordance with proper legal principles or else the resulting assessment would be incorrect. Accordingly, the TCC determined that on an appeal of the validity of the resulting assessment, it is within the TCC's power to review the manner in which the Minister came to her determination to deny the downward adjustment.

The FCA disagreed, making a distinction between the process and the product of the assessment. Specifically, the FCA found that the decision of the Minister would form part of the process of the assessment, while the TCC only has jurisdiction to consider the appropriateness of the productof that process (*i.e.*, the resultant assessment itself). Further, the TCC does not have the right to provide a remedy in the form of a review of a decision of the Minister as such relief requires the power to quash or issue an order of *mandamus*, which are powers the TCC does not have.

Iris: Facts and lower court decisions

Similarly to Dow, Iris was audited and assessed by the Minister under the ETA. In response, Iris applied to the FC for three declarations as well as appealing the assessments to the TCC. In its application to the FC, Iris sought declarations that:

- it was denied procedural fairness in the audit and assessment process (as the Minister departed from CRA policy);
- there was no evidentiary foundation upon which an assessment could be issued under the ETA; and
- the assessments were issued for the improper purpose of depriving the FC of jurisdiction to hear administrative law grievances raised by Iris in a related application.

The Attorney General moved to strike Iris' application. Both the Prothonotary and FC dismissed the Attorney General's motion to strike.

The Attorney General appealed these decisions to the FCA, arguing that the FC judge failed to recognize that Iris' application was essentially a collateral attack on the validity of the assessments, a matter within the exclusive jurisdiction of the TCC. The FCA determined that, where the grounds of review cited in an application to the FC are within the legislative mandate of the Minister under the ETA and the respective jurisdictions of the Tax Court and the Federal Court, the application constitutes a collateral challenge to the validity of the assessments issued under the ETA. With respect to the first declaration, the FCA found that, while any departure from CRA policy may give rise to legitimate expectations arguments, it cannot make the decision to assess or the assessment itself, invalid. Further, such a determination is within the jurisdiction of the TCC, as is the determination of whether there was evidentiary foundation for the assessment as was the case in the second declaration. With respect to the third declaration, the FCA found that the act of issuing a reassessment does not impact the

jurisdiction of the FC and that in any event, such a declaration constituted a declaration of fact which is not an available remedy under the FC application.

What's next?

While we wait for guidance from the SCC regarding the jurisdictional issues raised in *Dow* and *Iris*, it is important for taxpayers to continue to carefully consider the appropriate avenue of appeal for their circumstances. Where there are issues arising out of the correctness of the facts and law underlying an assessment, and also the actions or decisions of the Minister or CRA, it is often prudent to file appeals and/or actions in both the FC and the TCC.

If you have questions relating to your tax disputes and Tax Court jurisdiction, please contact the authors or another member of our Tax Disputes team.

[1] For other recent cases highlighting the jurisdictional issues between the FC and TCC please see, *1594418 Ontario Inc. v. Minister of National Revenue,* 2021 FC 157; *Her Majesty the Queen v. CBS Canada Holdings Co.,* 2020 FCA 4; and *Westminster Savings Credit Union v. Canada (Attorney General*), 2019 FC 1496.

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