

MEDIATION IN FEDERAL INCOME TAX DISPUTES

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In recent years the Government of Canada has begun adopting alternative dispute resolution mechanisms ("ADR") in many areas of its operations and administration. Such new uses of ADR, and mediation specifically, include the handling of personnel grievances in the federal public service, settling investment or trade disputes with other countries, and even as a means to avoid litigation in civil and other matters to which the federal government is a party. With the realization of savings in money, time, resources as well as other benefits, the government, and particularly the Department of Justice has announced the intention to more fully implement the use of such techniques as mediation and arbitration in the day to day conduct of its affairs. One area in which the use of mediation has been noticeably lacking is in the resolution of income tax disputes.

This paper will examine whether mediation could play a useful role in this area as well as why this method has historically been considered unsuitable for tax disputes [\(1\)](#)

and what barriers stand in the way of adopting such an alternative to litigation. Further, the innovations and lessons learned in other countries will be briefly considered in light of new developments in Canada to assess the likelihood of mediation being adopted here and to determine what steps must be taken in order to implement its use. Consideration will also be paid to the principles and features which the system design process must take into account. What will become apparent is that a solution which adequately balances the interests of taxpayers and government is highly elusive. Further, the design of a dispute resolution system is complicated by competing principles and legislative barriers, both of which are unique to income tax disputes. Before beginning this examination, however, a brief overview of the current process of appeals and dispute resolution and the way and rate at which disputes are resolved would be especially useful.

I. OVERVIEW OF THE APPEALS PROCESS

The Canadian income tax system is based on the principle of self-assessment whereby taxpayers declare their income and estimate their tax liability. Revenue Canada (or "the Department"), under the auspices of the Minister of National Revenue ("the Minister"), will then verify the amounts declared by the taxpayer and issue an assessment of the taxes payable. This assessment may either confirm or vary the taxpayer's calculation of the tax liability. In addition, in order to ensure voluntary compliance, audits will be conducted on the files of random or scientifically selected taxpayers for more detailed review. Quite frequently an audit will result in a reassessment. Under the *Income Tax Act*, [\(2\)](#) the taxpayer may dispute the Minister's assessment or subsequent assessments (reassessments) if the taxpayer is not satisfied with the Minister's explanations of the assessment; or if the Minister has denied the taxpayer's request for an adjustment; or if the Minister's interpretation of the income tax law is disputable. [\(3\)](#) In any of these cases, the taxpayer can deliver a written objection to the Appeals Branch of Revenue Canada, where an appeals officer considers the objection after consulting or negotiating with the taxpayer and either grants or denies the objection. This review is held out to be "impartial, objective and timely." [\(4\)](#) Also, and importantly, the basis upon which appeals officers grant or deny decisions is clearly set out in the *Taxation Operations Manuals*, which provides that

. . .the primary factor governing the decision is the assessment itself i.e. whether it is based on ascertainable facts supported by proper evidence and whether it is in accord with the law and Departmental policy. (5)

The Chief of Appeals of the local tax services office retains final discretion over these matters. If unsuccessful at this level the taxpayer can resort to the courts for judicial review.

At the Tax Court of Canada, the taxpayer may elect to file the appeal under the Informal Procedure whereby petitioners can represent themselves. Further, there are no filing fees and the legal and technical rules of evidence do not apply. Generally this option is available only where the amount in dispute is less than \$12,000 per assessment. In all other cases the General Procedure applies. While taxpayers may represent themselves under this procedure, the nature of the hearing is more legal and formal, a filing fee is payable, and the law of evidence applies. If the taxpayer's application is denied by the Tax Court of Canada, recourse can be sought at the Federal Court of Appeal and subsequently, with leave, at the Supreme Court of Canada. It is trite to mention that judicial review other than under the Informal Procedure at the Tax Court of Canada becomes increasingly formal, expensive, complex, time-consuming and legally burdensome.

This paper will focus specifically on the possibilities of mediation being employed at the level of the Appeals Division of Revenue Canada., some consideration may incidentally be paid to the possibilities of mediation arising from the case management features of the General Procedure at the Tax Court of Canada, which will be mentioned *infra*. First, however, the rates at which disputes are resolved without judicial verdicts would be of some use to this inquiry.

II. IS MEDIATION NEEDED?

Numerically, the Appeals Division of Revenue Canada seems an extraordinarily effective dispute resolution mechanism as it now stands. It is reported that over 95% of the 50,000 to 55,000 objections that are made to the Appeals Division each year are resolved, with only perhaps 3,000 to 4,000 proceeding to the Tax Court of Canada. (6) The outcome of objections filed with the Appeals Division in 1996-97 was as follows: Minister's assessment confirmed - 34 percent; objection allowed in part - 19 percent; objection allowed in full - 27 percent. Further, 20 percent of objections were considered invalid or requested compassionate relief from interest and penalties. (7) Before drawing any conclusions from these numbers, one must consider the number of rejected objections that proceeded to trial. Of the 4,014 objections that were appealed to the Tax Court in 1996-97 under both the General and Informal procedures, there were only approximately 1,700 judgements rendered after trials while 900 suits were settled before trial, and the remaining 1400 appeals were abandoned by the taxpayer or dismissed. Further, following judgement in the Tax Court, only 160 taxpayers took their cases to the Federal Court of Appeal. (8)

From the above numbers at least two inferences can be drawn. First, while Revenue Canada's internal objection resolution mechanism does indeed appear to resolve the vast majority of objections, there are still a significant number proceeding to court. The cost to the government of preparing for these matters, even if they are subsequently dropped by the taxpayer, is significant. In 1997-98 the cost of work done for Revenue Canada by lawyers of the Department of Justice, who litigate tax matters in the courts, was \$5.4 million. (9) In addition, the cost in time, money and human resources of the preparatory work done by Revenue Canada would presumably surpass this amount considerably. The cost to individual taxpayers is also a consideration. A second and more fundamental observation, however, is that the

number of cases proceeding to court, though perhaps low, may itself signify that the dispute resolution process at Revenue Canada's Appeals Division is not satisfactory. This conclusion, without first considering Revenue Canada client surveys, could be theoretically sound if one were to consider the possibility that some of the 19,000 taxpayers whose objections are overruled may well have a strong case but may lack the will or courage to pursue them in court, even under the Informal Procedure. What further lends support to the conclusion that the Revenue Canada objection resolutions process may not be as well-designed as it could is the fact that appeals officers are often alleged to be less than impartial and objective in dealing with objections. This characteristic might be summarized conveniently as "bureaucratic closed-mindedness" and perhaps it should be examined briefly since it is one of the features that make income tax disputes and their resolution unique.

While Revenue Canada proclaims that the review of objections conducted by appeals officers is impartial and objective, some practitioners and perhaps many taxpayers may argue that the contrary is more accurate. While Revenue Canada states that the Appeals Division is independent of the rest of the Department and that the officers who review an objection have not been involved in the original assessment or reassessment,¹ (10) it has been suggested that appeals officers, most of whom have already served a "tour" as auditors (who are commonly characterized as suspicious, confrontational individuals as per the age-old stereotypes), are not willing or able to adapt to their new roles, and that an "audit mindset" continues to govern their decision-making. Stated another way, appeals officers may "afford undue deference to the opinions of their audit and head office colleagues, to the point of closing their minds to any contrary opinion."¹ (11) This retention of the audit mentality is not entirely unfounded by the objective facts at hand. Part of Revenue Canada's practice of regularly rotating its employees among the different branches, the most senior employees (with an average of 12 years field experience) are customarily assigned to Appeals.¹ (12) In the vast majority of cases, then, the appeals officers will most likely have served as auditors for some time before joining Appeals Division. Further, the relatively inadequate training for appeals officers, as discovered by the Auditor General's Office, is another possible cause of the proliferation of the audit mindset.¹ (13) Last, though it may be trite to say, appeals officers may consider maintaining or enhancing their career prospects with Revenue Canada and their relationships with their colleagues above conducting reviews in accordance with the Department's publicly-stated principles.¹ (14) With these factors in mind, the notion of receiving an impartial and objective review at Revenue Canada becomes slightly tarnished. It is little wonder then that Revenue Canada launched a new initiative to re-examine the ways in which it conducts reviews. These measures will be briefly described at this point.

In April 1997, the Minister announced the Appeals Renewal Initiative ("ARI") in response to growing concerns, as apparent from the Department's client surveys, that the in-house appeals process was not widely perceived as impartial, timely and objective.¹ (15) The ARI was designed to instill greater public confidence in the objection resolutions system by, first of all, adding greater transparency so as to ensure the independence of appeals officers.¹ (16) Second, wider access to legal advice was granted to appeals officers,¹ (17) perhaps to help identify and assess legal issues so as to ensure sufficient information is available to reach a more accurate or reasonable appeal decision. Further, the ARI marked the beginning of an examination of the current prohibitions on settlement and a feasibility study of utilizing ADR, and, last, an advisory committee was formed to solicit input from the public, to formulate new strategies and recommend them to the Minister.¹ (18) The announcement that ADR is being considered may perhaps be a strong indication that bringing third parties into talks between taxpayers and appeals officers is a necessary step to improving the objection resolutions process. As a speculation, ADR may have been considered necessary since, despite the other components of the ARI, attaining objectivity and impartiality in appeals officers may be little more than wishful thinking, given the systemic reasons stated above and the frailties of human nature, specifically bureaucratic intransigence.

From the foregoing, a clear and conclusive need for the use of ADR in income tax disputes is elusive,

and can only be found by inference. There is no doubt that the surveys of taxpayers and their representatives would be most illuminating in this regard.¹ (19) In the United States, where a similar in-house appeals process is provided by the Internal Revenue Service, the Appeals Division is likewise not considered to be "truly independent" of the rest of the IRS, and the taxpayer is "less apt to be satisfied."² (20) It can be safely stated, then, that it would be the perception of the taxpayers and their representatives that would provide the impetus for implementing ADR. From the previously stated statistical results of the appeals process as it stood prior to the announcement of the ARI, one can see that Revenue Canada would not, on its own initiative, implement alternative measures in its process. Indeed, the Department stated in its ARI documentation that its appeal process is "recognized as one of the best in the world."² (21) Nonetheless, one can make the assumption that taxpayers and their professional representatives desire ADR to be implemented. Revenue Canada, increasingly sensitive to the wishes of the public in its "client-centred" approach, presumably adopted to foster the public's perception of integrity in the tax system,² (22) and perhaps encouraged by the expansion of ADR spearheaded by the Department of Justice,² (23) may be very well advised to implement the use of such measures. Further, the costs of litigation borne by the government, as discussed above, are substantial. It stands to reason that if even a small increase in the number of cases diverted from litigation is achieved, this will amount to realizable savings. Similarly, taxpayers able to resolve their disputes satisfactorily out of court may enjoy savings. This may, in turn, lead to greater taxpayer satisfaction with the tax system, which, as will be discussed below, is indeed a priority of Revenue Canada.

In conclusion, if the need for the implementation of ADR is real and pressing, it is now necessary to examine what obstacles stand in the way of introducing it to income tax disputes. Following that, some of the principles which must be taken into account during the design and implementation of a new dispute resolution system for income tax disputes will be identified and discussed.

III. BARRIERS TO IMPLEMENTATION

This section will discuss the various impediments which must be addressed or overcome before ADR, and mediation specifically, can be successfully adopted. For convenience, these obstacles can be categorized under two headings, namely legislative or judicial and systemic. First, it is a commonly-known fact that the *Income Tax Act* is perhaps the most complex piece of legislation passed by Parliament. Nearly every aspect of income tax, from its calculation to auditing to collection and to appeals is precisely prescribed in legislation or regulation. It stands to reason, then, that implementing ADR requires far more than a simple change in procedures. In addition, there are several policies or fundamental principles which are unique to the collection of income tax which any system of dispute resolution must take into account. During this discussion, several observations will emerge which will be critical in the design process of any new dispute resolution system. These will be highlighted wherever practical. At this point, the legislative barriers will be examined.

The Minister of Revenue is, for all intents and purposes, a creature of statute. That is to say that the powers of the Minister are definitively laid out in the *Act*, and there is, with few exceptions, little room for discretion in the assessment and collection of tax. This precept is particularly notable in the case of compromise settlements, also known as "saw-off" arrangements, whereby the taxpayer's liability is reduced by any amount not provided for in the *Act*. On this issue, Canadian courts have held that:

[T]he Minister has a statutory duty to assess the amount of tax payable on the facts as he finds them in accordance with the law as he understands it. It follows that he cannot assess for some amount designed to implement a compromise

settlement.² (24)

And that such an "agreement whereby the Minister would agree to assess income tax otherwise than in accordance with the law would . . . be an illegal agreement."² (25) This is not to say, however, that no room for compromise exists. One notable exception to the above judicial statements is with regard to valuations of assets or property, where independent experts determine the value of the asset for the taxpayer to include in its tax return. Valuation is a matter of fact, not of law, and so if the value of a particular asset is debated, the Minister can settle a dispute with the taxpayer by compromising on the value in question.² (26) In addition, it is possible to bypass the court-imposed ban on compromise agreements by the taxpayer and Minister agreeing to "re-characterize" income or deductions so that they attract a different (and usually lower) tax liability. While a simple and quick way to resolve disputes,² (27) this method may raise systemic issues of consistency of the application of tax law and equality in the treatment of taxpayers, which will be discussed shortly. As an observation, this issue of characterization may be a suitable one for mediation, and will be revisited later in this paper.

As an illustration of the sort of change that would need to be made in order for the Minister to make compromise settlements, one can look to s. 220(3.1) of the *Act* which provides that the Minister "may, at any time, waive or cancel interest or penalties otherwise payable."² (28) The Minister previously did not have the power to grant this sort of relief. This example helps illustrate the fact that the sole source of the Minister's powers is the *Act* and powers not provided for in the *Act* are not available for the Minister's use. It has to be stated at this point, however, that the Minister is not precluded entirely from entering into settlements. Only the *type* of settlement is restricted. It is entirely possible, therefore, for the Minister, represented by agents of Revenue Canada, to enter into mediation sessions. In response to criticism over the Minister's inflexibility to enter into compromise settlements, the Appeals Renewal Initiative document suggested that a statutory amendment to the *Act* was under consideration.² (29) Such action has been subsequently recommended by the Technical Committee on Business Taxation in its report³ (30) to the Minister of Finance, who is ultimately responsible for the *Act*.

In addition to the statutory bar to the Minister settling tax disputes, even in cases where an agreement is reached, such as in regard to a valuation or re-characterization, the settlements are not, at current, enforceable by the taxpayer and, furthermore, the taxpayer may be bound to its detriment even if Revenue Canada reneges.³ (31) The most frequent scenario is Revenue Canada offering to reassess the tax liability in favour of the taxpayer in return for a waiver of the taxpayer's right to object to the reassessment.³ (32) This state of affairs quite clearly undermines the settlement system substantially and would render the employment of ADR techniques almost useless *ab initio* since a taxpayer would be loathe to consent to be bound by an agreement which the Minister could easily avoid. The principle of good-faith is certainly vulnerable under this set of conditions. It has also been observed that this ability of the Minister to escape its agreements arbitrarily only serves to undermine the perceived integrity of the tax system.³ (33) The public's perception of the tax system also serves as a systemic obstacle to employing ADR methods, and is the next topic of discussion in this section.

Another statutory obstacle, though particular to only the ADR technique of arbitration, is the fact that the *Act* does not recognize the authority of a third party to assess taxes payable. A third party arbitrator would have no authorization to fix the liability of the taxpayer in a settlement since only the Minister, or judges or justices of the courts in an appeal have this power.³ (34) Further, such an arbitration would be relatively impotent unless the statutory and judicial bar to compromise settlements is lifted, for the reasons discussed *supra*. In addition, the income tax dispute system is already equipped with neutral third-party decision-makers, namely judges of the Tax Court. A taxpayer would most likely, and would probably be best advised to, rely on a judge rather than a lay arbitrator. This supposition is based on the probability that if the taxpayer submits in advance to a binding decision by a third party, more satisfaction and a greater sense of finality can be had after getting his or her "day in court." Last, to add

arbitration to the dispute resolution process would require some substantial changes, since it would, after all, render the courts redundant. This is neither necessary nor desirable since the Informal Procedure of the Tax Court already provides the taxpayer a free and informal hearing by a judge with considerable expertise in taxation law. As will be mentioned in the design section of this paper, the purpose of implementing ADR is not to replace the judicial review component of the tax dispute process, but only to provide greater opportunity for agreeable settlements before the matter is taken to court. It is concluded here and elsewhere,³ (35) therefore, that arbitration is not a suitable ADR technique in income tax disputes in Canada.³ (36)

In order for a tax system based on self-assessment to be effective, that is, to encourage voluntary compliance, it must be seen to have integrity in that it "engenders perceptions of fairness, reflects consistency across tax bases and taxpayers, and enhances efficiency in its operations."³ (37) The use of ADR in income tax disputes may be questionable to some degree since it would give rise to the possibility that taxpayers equally situated would be treated differently. The outcomes of mediation sessions, for instance, may very well differ from case to case because of the personalities of the players and the existence of any aggravating or mitigating circumstances. A seasoned tax litigator has responded to this argument by stating that such inconsistency is already taking place, particularly in the agreements that Revenue Canada chooses to honour or dishonour, as discussed above.³ (38) More convincing, however, is the fact that uniformity can be maintained much the same way it is at the current appeals level.³ (39) Specifically, appeals officers would be given specific instructions or criteria, and authorization as to what they would be permitted to offer or accept in a situation of any given sort. Furthermore, as in the case of appeals today, mediation could be taken over by the Appeals Division at Revenue Canada's Head Office in Ottawa. The *Taxation Operation Manuals* provide that appeals in which certain issues are disputed must automatically be referred to Head Office where specialists will take up the file, oftentimes to preserve uniformity in the application of the law.⁴ (40) In the case of mediation, the Department could train a staff of specialists with equal expertise who would be fully authorized to represent the Minister in mediation sessions while applying Departmental policies uniformly, and station these individuals at the various District Offices. This would remove the need for taxpayers and their representatives from travelling to Ottawa.

Having considered some of the barriers to implementing ADR and some of the basic ground rules under which Revenue Canada operates, the design of a new or modified system can be undertaken.

IV. PRINCIPLES FOR THE DESIGN PROCESS

This paper has, so far, examined the income tax dispute resolution system as it now stands, and has concluded that employing ADR techniques may be useful in its efficient operation and in giving more satisfaction to the taxpayer. Also, some of the obstacles unique to income tax disputes have been highlighted. At this point, certain key features necessary in the design of an ADR system can be contemplated, and the role of the new system in the context of the one currently in place can be ascertained.

This brief overview of the key principles which must be considered in the design process will begin with a problem diagnosis or needs analysis, which will highlight the deficiencies or weaknesses in the current system which are to be addressed by a new or modified system. Second, the outcome objectives, or purposes and goals of the new system will be defined.⁴ (41) Last, the new process, and its integration with the existing system will be briefly laid out.

A) Problem Diagnosis / Needs Assessment

The earlier sections of this paper will serve as the basis from which to draw conclusions as to any aspects of the current income tax dispute resolution process which are wanting or lacking, as well as what features are particularly positive. The Appeals Renewal Initiative was launched in response to results of a survey undertaken by Revenue Canada with regard to taxpayer satisfaction with the appeals process.⁴ (42) As stated several times in this paper, the public's perception of a fair and timely redress process is critical to ensuring voluntary compliance with the *Act*. The ARI and the recent discussion paper by Revenue Canada⁴ (43) further call on taxpayers to proffer suggestions as to how to improve the system. There is little room for doubt, therefore, that the wishes of the client (the taxpayer) play a key role in the development and delivery of Revenue Canada's services. It follows, then, that the design process for the dispute resolution system will be client-focussed. After a brief consideration of the administrative aspect of the current system, the problems reported by taxpayers will be examined.

As previously discussed, the current appeals system at Revenue Canada is generally admitted to be an efficient and timely process from an administrative perspective. The efficiency of the conduct of judicial review at the Tax Court is equally impressive. By all accounts there are no backlogs or significant delays in scheduling and conducting hearings at the Tax Court, and the system seems by no means to be awash with cases.⁴ (44) These facts are not mentioned here to suggest that a problem or deficiency exists in the current system. On the contrary, they show that the current system is administratively adequate (and perhaps more than adequate). This recognition will help to narrow the scope of the design process, particularly by distinguishing the tax dispute resolution system from the civil litigation system, for instance. In the case of the Ontario Court (General Division), mandatory mediation was prescribed on a pilot basis since civil litigation was creating backlogs, greater expenses to both the system and to the parties, and the process was such so as to actually *discourage* settlement.⁴ (45) It has already been stated that no such problems exist in the case of tax disputes, but it is interesting to note that until the mandatory mediation was implemented in Ontario, there was no formal step before the case was heard by a judge. Since the problems in these two scenarios are substantially different, it is very likely that any system designed for income tax disputes will be, by necessity, different than those prescribed for civil litigation.

Turning now to the most pronounced problem with the current income tax appeals process, namely the lack of independence, objectivity and impartiality of the Appeals Branch of Revenue Canada, ADR may well be seen to play a useful role. It is opined that despite the unveiling of the Appeal Renewal Initiative by the Minister, no appreciable difference can be realized with regard to the independence of appeals officers vis-à-vis their colleagues in other divisions of the Department.⁴ (46) Since the dissatisfaction of taxpayers and their representatives seems to arise from the fact that Revenue Canada selects its appeals officers from the ranks of its seasoned auditors, and that these individuals bring their "audit mindset" to the new role, it becomes apparent that it is the organizational structure of Revenue Canada and its relationship with taxpayers which, more than the type of disputes,⁴ (47) must be addressed in any new system.

It is worthy to add at this point that it is obvious that the animosity that most taxpayers feel towards Revenue Canada (or any revenue collecting agency) may also play a role in the low levels of satisfaction, even if the appeals officer is genuinely impartial, objective and negotiating in good faith. Although the Canadian income tax system is based on voluntary compliance, taxpayers do not have dealings with Revenue Canada by choice; *i.e.*, paying one's tax liability is compulsory. Little has been said thus far in this paper about how the taxpayer's approach with the appeals officer may taint the likelihood of a favourable outcome, but this possibility may very well exist.⁴ (48) The relationship between taxpayers and the Department in general has been, historically and by nature, confrontational, and is quite likely an element which hinders favourable outcomes and adds to taxpayer dissatisfaction. It is speculated here that taxpayer dissatisfaction, no matter from what particular aspect of the process it arises, may frequently prompt the individual to become entrenched in its views, and the desire for one's

"day in court" may, in some cases, become much stronger. This may present yet another reason why client satisfaction plays an important part of Revenue Canada's decision to implement the Appeals Renewal Initiative and to consider the use of ADR.

Against this set of problems, the need for a third party is especially prevalent. This section has, thus far, alluded to the fact that both parties to an income tax dispute may not be able to deal with each other in an impartial, objective and calm manner, presumably due to the unique confrontational characteristics associated with this type of dispute. Adding a "buffer" or a referee of some sort between the taxpayer and the appeals officer may, in such cases, prove beneficial in that it may afford an atmosphere in which meaningful discussions marked by effective communication may be had and favourable outcomes achieved. Some consideration ought to be paid now to the qualifications and role of this individual.

Again it is stated that income tax legislation is particularly complex, and it stands to reason that the neutral third party ought to be well-versed in the intricacies of the *Act*, so as to be able to identify issues and subtly steer the parties towards areas on which consensus can be reached. Further, an individual intimate with income tax law is desirable in light of the judicial and legislative bars to settlement, since, as discussed above, an illegal settlement will be of little value to the taxpayer. As to the specific type of status this individual should have with regard to the process, it will be remembered that arbitration has been discounted as an option in Canadian tax disputes.⁴ (49) Mediation is thus the best option. It can be further suggested, however, that evaluative mediation, whereby the facilitator would provide an opinion as to the merits of the cases presented by both sides, be employed if the taxpayer so requests. This suggestion would be particularly valuable to the taxpayer who is not represented by counsel, which may be the norm in informal proceedings such as this, and thus the taxpayer may not have an informed opinion of his or her chances in court. The benefit of the evaluative mediation is almost exclusively the taxpayer's, since Revenue Canada officials have access to legal advice from Department of Justice counsel.⁵ (50) On the other hand, if a taxpayer is advised by the evaluative mediator that his or her chances are slim to nil, that taxpayer may be more apt to settle or abandon the claim and not proceed to Tax Court, saving all parties, including the Department, the expense and time required for litigation. Appropriately, if rendering an assessment which the taxpayer may rely upon, it is imperative that the mediator is both skilled in tax law and entirely independent of Revenue Canada and the Department of Justice. The skill of the mediator in tax law is crucial since to the untrained eye almost all cases can seem watertight in the Minister's favour. It is not desirable to actively discourage taxpayers from proceeding through the Informal Procedure at the Tax Court since this, too, would leave the taxpayer dissatisfied or without a sense of finality or understanding.

In this discussion of the problems of the current appeals process, some basic principles have been addressed and the development of the form of the new system has begun. While some of the objectives and goals have already started to emerge, these and others will be identified and discussed more fully in the next section.

B) Defining Outcome Objectives

Several outcome objectives have already been identified throughout this paper. For convenience they will be categorized and expanded upon in this section. As stated in the needs analysis, this design process is client-focussed, and so it will be of little surprise that most of the objectives herein will be centred around the taxpayer.

First and foremost, the new system must give taxpayers the feeling that they are being treated fairly and impartially. It is suggested here that poor communication may be the underlying cause of dissatisfaction for taxpayers in the current system. The criteria by which an appeals officer is bound to make the decision to grant or deny an objection⁵ (51) is ambiguous and must be explained to the taxpayer in

terms specific to the particular issue of the objection under review. This can be seen to be a prime source of misunderstanding on the taxpayer's part and the impetus for further action, namely in the courts. The skill of the mediator in rephrasing and resetting the appeals officer's explanations may help clarify any areas which might otherwise be misinterpreted. This might have the favourable result of staving off any notions of unfairness or injustice on the taxpayer's part. This objective, which is not only process-related, but is also perhaps related to systemic change, seems to be the governing one in that the process itself is more important than the outcome and a change to the system, though not fundamental, may be seen to occur. It is probably the opinion of the Department that if taxpayers believe the system treats them with fairness and impartiality, they will be satisfied with the system regardless of whether the objection is resolved in favour of the taxpayer or not. This opinion is concurred in by the author of this paper.

In a related vein, if mediation, with its emphasis on restatement, is useful in helping change the perceptions of the taxpayer, the same may be true as regards the appeals officer. With the confrontational undertones removed in the restatements by the mediator, the appeals officer may better understand the perspective, questions and concerns of the taxpayer, and may therefore be able to better address them. It bears mentioning at this point also that the qualities of mediation are such that perhaps both taxpayer and assessment officer alike may undergo something of a transformation, as described by Bush and Folger.⁵ (52) Specifically, the experience may allow each party to better relate to the other, which may help break down the stereotypes each holds of the other, and to make transactions between them more personalized than the age-old "taxpayer versus tax collector" and vice versa. Though perhaps overly idealistic in the case of income tax disputes, the transformative view of mediation is an attractive one.

Monetary considerations also play a part in the objectives of the new dispute resolution system, though they are not as high a priority. While it is true that client satisfaction is the paramount consideration in this case, it will be remembered that the ultimate end is to ensure voluntary compliance in the remittance of income tax. Thus, the cost to the government of the proposed program is better characterized as an investment than as an expense. It is also a fact that increased satisfaction and better communication may divert cases from litigation, thus conserving government resources, which is most likely a secondary objective.

From the taxpayer's perspective, the issue of monetary savings (other than the tax liability, of course) as an objective of the new system also plays a role in the design process, though it is relatively smaller than as with the government, since the Department bears the cost of its appeals process, and the fees at the Tax Court are quite low under the General Procedure and are nil under the Informal Procedure. The taxpayer will certainly realize savings if mediation diverts an action which would proceed through the upper levels of judicial review, and these savings would likely contribute to the taxpayer's satisfaction with the system, as per the prime objective, above.

Quality outcome goals, or securing better results than would be realized from litigation, plays a small role at the current time. If, however, the statutory and judicial bar to compromise settlements is lifted, there is no doubt that this objective in a dispute resolution process would be more prominent. Much has been written on the "hazards of litigation" approach to settlements in income tax disputes, and this approach is currently in use in the United States, where no equivalent to the Canadian bar to compromise settlements exists.⁵ (53) In essence, this approach calls for an assessment of a party's chances in court and the probable result, and then a compromise may be struck with the other party in an attempt to maximize (or minimize, as the case may be) the tax payable. The quantum of the settlement would usually be proportional to the relative chances of the parties.⁵ (54) Mediation may be useful in helping the parties relay to each other their beliefs as to their respective chances in court and in reaching a compromise settlement.

Now that the problems of the current system and the goals of the new system have been laid out, it may be rewarding to examine one possible way in which the discussion in this paper can take form.

C) Integration of New With Current

What is proposed in this paper is a mediation component to follow the initial negotiations between Revenue Canada appeals officers and the taxpayer. As previously noted, approximately 95% of objections are resolved at the negotiations stage, with a full third of them being allowed in the taxpayer's favour. To modify this component of the dispute resolution process would be unwise for three reasons. First, negotiation is a simple and cost-effective method to resolve disputes and in many of the less complex cases is the only step that is required.⁵ (55) Second, many taxpayers may be able to deduce on their own from their negotiations and discussions with the Department that they have little or no chance of success in court. Third, purely frivolous or vexatious objections⁵ (56) can be identified at an early stage and precluded from any further ADR opportunities, so as not to waste Departmental resources. It is admitted that the initial complaint by taxpayers of not receiving a fair and objective review is not addressed by maintaining this step of the procedure. Again, the statistics are simply too impressive to justify the removal or substantial modification of this component. One would hope that Revenue Canada's Appeal Renewal Initiative can help make the experience less unpleasant. In any event, an optional mediation component shall be available to any qualified taxpayer wishing to get a better understanding of the Department's reasons in refusing to allow the objection in whole or in part or to resubmit the case for consideration.

Before discussing the mediation phase itself, some regard ought to be paid to the cases in which mediation may be unsuitable. As discussed in the "Barriers" section of this paper, there are certain types of cases which, at the objection stage are referred to Revenue Canada's Head Office. These cases are typically those which deal only with questions of law⁵ (57) and, owing to the bar on compromise settlements, ought not to be eligible for mediation. Similarly, cases which invoke the *Canadian Charter of Rights and Freedoms*,⁵ (58) or that are under investigation for criminal tax evasion, or cases of a novel nature and useful for their precedential value should be excluded from mediation for public policy reasons as well as to maintain a uniform application of the law.⁵ (59)

The use of mediation and arbitration in the United States has been examined, and its adoption in Canada has been said to be complicated by, *inter alia*, the statutory bar to compromise settlements and the prohibition on delegating powers to third parties. Three key principles have emerged, however, which could and should play a part in any similar Canadian project. First, entering into mediation must be consensual. Second, as stated above, certain types of cases would be ineligible for mediation. Third, not all cases falling outside the ineligible class would necessarily be suitable for mediation.⁶ (60) Unlike Ontario civil courts and American tax courts the Revenue Canada appeals process and the Tax Court of Canada are not swamped with cases and plagued by delays.⁶ (61) There is no need, therefore, to impose a mandatory program or to make eligible a wider number of types of cases. The emphasis in a mediation component in the Canadian tax setting is on qualitative rather than quantitative considerations. Put another way, the purpose of such a mediation program is to provide taxpayers the best possible opportunity to get fair, objective and impartial treatment in an environment facilitative to clear and effective communication rather than only to divert cases from, or expedite the movement of cases in the docket. It stands to reason, especially after considering the small number of cases that actually do proceed from the Revenue Canada Appeals Branch to the Tax Court of Canada, that a mediation program such as the one described will not be utilized nearly as much as in Ontario civil courts and in American tax courts, but it is submitted that the cases that do make use of the program would contribute to both taxpayer satisfaction and administrative efficiency.

V. CONCLUSION

Ironically, the old adage "if it ain't broke, don't fix it" seems to both apply and not apply in the case of the appeals conducted at Revenue Canada. While the statistics are indeed very impressive, there seems to exist simultaneously a wide-spread feeling of discontent with the system. To abandon or entirely overhaul the current regime would likely mean sacrificing all vestiges of efficiency. At the same time, to leave the system untouched may ultimately erode the integrity of the national tax system. Discussions and studies are taking place at the present day inside and outside government to develop a magical solution which would answer both concerns. As shown in this paper, there are competing principles which any new system must attempt to reconcile, and legislative limitations which must be overcome. The magical solution of balancing the interests of taxpayers and government will indeed be elusive. What is certain, however, is that the widespread and rapidly-growing use of ADR in the government's day-to-day operations will be extended to include income tax disputes in the not-to-distant future.

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1. 01By way of clarification, this paper deals exclusively with disputes arising from the assessment of income tax. Appeals regarding unemployment insurance, the Canada Pension Plan, sales and excise taxes, customs duties, and any matters related to the criminal offence of income tax evasion, lie outside

the scope of this paper.

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49. 049 *Supra* note 35 and accompanying text.
50. 050 This access has been expanded under the ARI (*supra* note 13 and accompanying text).
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56. 056 There are no statistics for the frequency of these cases in Canada, but apparently they account for 11% of tax cases in the United States (McDonough, *supra* note 20 at 42).
57. 057 *Supra* note 40 and accompanying text.
58. 058 Part 1 of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c. 11.
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61. 061*Ibid.* at 12:13.

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