

TAX COUNSEL

STRETCHING THE LIMITS: THE DOCTRINE OF REASONABLE DISCOVERABILITY

JULY/AUG 2001

“...limitation periods must be viewed from a perspective of fairness, not only to the potential defendant but also to the plaintiff.”

Can an invalid assessment with no foundation be enforced simply because the time limit for appealing it has passed? The Crown's view in the case of *Carlson v. Her Majesty the Queen* was that the passage of time provided an absolute barrier to setting aside such an assessment. That may, in fact, be a correct view of the law in many cases. It was not, however, the view held by Porter, D.J.T.C.C. in the *Carlson* case. The facts of that case are that Carlson helped a friend (Avery) to obtain the necessary development permits for rental property in Edmonton by having that property transferred from Avery's to Carlson's name. No money changed hands. Carlson was a bare trustee. Some time later, Carlson transferred the property to Avery's son. Again, no consideration came to him.

On August 17, 1993, Carlson received from Revenue Canada a Notice of Assessment in the amount of \$43,000.00 pursuant to subsection 160(2) of the *Income Tax Act*. It referenced certain “transfers from Sunwapta Construction Ltd. on or about September 1, 1992 of real estate located at ... Edmonton, Alberta, legally described as ...”.

Carlson called an unknown person at Revenue Canada and provided the explanation. He was told by that person that inquiries would be made and Revenue Canada would get back to Carlson in due course. Of course that never happened. In fact, nothing happened until five years later when the assessment showed up on the computer screen of another Revenue Canada employee who was discussing an unrelated matter with Carlson. In short order, demands were made for payment of the \$43,000.00 plus interest. Carlson's wages were subsequently garnisheed, a circumstance characterized by Justice Porter as bordering on the iniquitous.

Technically, Carlson was out of time to protest the assessment. Section 165 of the *Income Tax Act* had allowed him 90 days from the date of assessment to serve a Notice of Objection upon the Minister. Having missed that time period,

Carlson was allowed one full year after expiry of that 90-day period to apply for an extension (s. 166.1). Carlson did not comply with either of these provisions. All he did do was speak to a Revenue Canada employee on the phone, and to his friend Avery.

In rendering his decision, Justice Porter reviewed some Supreme Court authorities dealing with time limitations. The first was the case of *K. (M.) v. H. (M.)*,¹ a civil lawsuit arising out of incest. A strict reading of the applicable *Limitations Act* showed that case had similarly been brought out of time. Justice LaForest of the Supreme Court described three underlying rationales for limitations periods:

1. Certainty: A potential defendant should be secure in his reasonable expectation that he will not be held to account for ancient obligations;
2. Evidentiary: It is legitimate to foreclose claims based on stale evidence;
3. Diligence: Plaintiffs are expected to act diligently and not “sleep on their rights”.

The Supreme Court went on to state, however, that limitation periods must be viewed from a perspective of fairness, not only to the potential defendant but also to the plaintiff. LaForest invoked the reasonable discoverability rule:

“... a cause of action arises for purposes of a limitation period when the material facts on which it is based have been discovered or ought to have been discovered by the plaintiff by the exercise of reasonable diligence ...”²

Before the *Carlson* case, the reasonable discoverability rule had been applied and extended to cases between private citizens, sexual assault, professional negligence and other torts, but never to a taxpayer. Justice Porter pointed out, however, that Revenue Canada itself had been the beneficiary of court leniency in the Federal Court of Appeal case of *Carew v. Canada (M.N.R.)*³ where the Minister

STRETCHING THE LIMITS (CONT'D)

“No longer may we dismiss out of hand the prospects of a client who ignored all the normal time limits.”

was allowed to file a Reply to a Notice of Appeal one day after the time period had expired.

With this in mind, Justice Porter applied the reasonable discoverability rule and allowed Carlson to file his Objection several years after the Notice of Assessment. He made it clear that it would only be in the rarest of cases the discoverability rule would apply to matters arising from the ITA. The factors that he looked at in this case, and which served to sway him to find in Carlson's favour, included the following:

- (a) Carlson received no gain from the transaction;
- (b) Carlson was a simple, uneducated man;
- (c) In the four-line assessment sent to Carlson, there was not a word of explanation of what the assessment had to do with him;

- (d) No covering letter was sent with the assessment;
- (e) The Revenue Canada official who spoke to Carlson after the initial receipt of the assessment never contacted him again, as was promised;
- (f) No action was taken on the assessment by Revenue Canada until five years after the fact.

Even though, as Justice Porter has said, Carlson's is a rare case, this ruling has an impact. No longer may we dismiss out of hand the prospects of a client who ignored all the normal time limits. Rather, we must critically examine the reasons for that client's failures to determine if the client fits under the umbrella of "reasonable discoverability".

¹ [1992] 3 S.C.R. 6

² *Central Trust Co. v. Rafuse* [1986] 2 S.C.R. 147

³ [1992] F.C.J. No. 1020, DRS 94-13191

SHE DOTH PROTEST

An interesting application was made in May before Justice Bowman of the Tax Court of Canada over a paltry \$3.50 worth of G.S.T. One Maxine Collins, a very principled individual, was charged GST on a \$50.00 withdrawal fee when she withdrew amounts from her self-directed RRSP. She filed an appeal under the General Procedure Rules, paying a filing fee of \$250.00. Her aim was to obtain a Judgment under the General Procedure, which would be binding on CCRA and would alert other Canadian taxpayers to this erroneous charge. Counsel for the CCRA attempted to cut her off at the pass by filing a Consent to Judgment without costs, signed by a CCRA representative, but not by Ms. Collins. Had this tactic been successful, Ms. Collins would have been returned her GST but her other objectives would have been thwarted.

The determined Ms. Collins applied to Justice Bowman for directions as to the procedure to be followed in order to obtain written reasons, arguing that the Consent to Judgment would have no precedential value whatsoever. Justice Bowman pointed out that a "consent" signed by only one party could at best be treated as an offer to settle a case by paying back the \$3.50 without costs. That offer having been rejected by the appellant, she was entitled to her day in court and whatever reasons might follow. It appears CCRA bought more than it bargained for with that \$3.50.



Suite 100 - 10328 - 81 Avenue
Edmonton, Alberta
Canada T6E 1X2

Tel (780) 439-7171
Fax (780) 439-0475

Prowse Chowne LLP, North America's first ISO 9002 certified law firm, provides sound business law advice and litigation counsel. Prowse Chowne LLP works closely with its clients and their professional advisors to ensure clients achieve their tax objectives in a manner that makes legal, financial and business sense.

To ensure you receive a copy of Tax Counsel, please forward your contact information (including name, company, complete address, telephone and fax numbers, and e-mail address) to Don Mallon by fax (780) 439-0475 or by e-mail taxcounsel@prowsechowne.com.

Donald P. Mallon, BSc LLB, a partner in Prowse Chowne LLP, is a seasoned litigator with over 20 years of experience. Focusing on administrative and tax litigation, he draws upon his courtroom and negotiation skills to effectively represent individual and business taxpayers in disputes with Revenue Canada.



ISO 9002 Registered Firm
QCB Certificate #96-328