Federal Court of Appeal | Cour d'appel fédérale

Date: 20230608

Docket: A-82-22

Citation: 2023 FCA 133

CORAM: **PELLETIER J.A.**
DE MONTIGNY J.A.
GLEASON J.A.

BETWEEN:

HIS MAJESTY THE KING

Appellant

and

MARGO DIANNE BOWKER

Respondent

Heard at Vancouver, British Columbia, on March 29, 2023.

Judgment delivered at Ottawa, Ontario, on June 8, 2023.

REASONS FOR JUDGMENT BY: PELLETIER J.A.

CONCURRED IN BY: DE MONTIGNY J.A.
GLEASON J.A.

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REASONS FOR JUDGMENT

PELLETIER J.A.

I. Introduction

[1] In reasons reported as 2021 TCC 14, the Tax Court of Canada allowed the respondent Ms. Margo Dianne Bowker's appeal from the Minister of National Revenue's assessment of a penalty of $139,000, more or less, pursuant to subsection 163(2) of the *Income Tax Act*, R.S.C. 1985 c. 1 (5th Supp.) (the ITA) for, colloquially, gross negligence in making a false statement in

an income tax return. The circumstances giving rise to the penalty were that the respondent relied on a firm of tax preparers to draft and file on her behalf an amended return for her 2010 taxation year in which she claimed large business and capital losses when she had never operated a business. The respondent was essentially passive in the exercise and gave the tax preparers and her husband free rein without any oversight on her part. The Minister refused the claimed losses and imposed the gross negligence penalty.

[2] After giving the parties the opportunity to make submissions on the issue of costs, the Tax Court awarded the respondent partial indemnity costs equal to 75% of her actual legal expenses (including taxes) and 100% of her disbursements. This is an appeal of that decision, which was reported as 2022 TCC 43 (the Decision). There is no issue as to the disbursements.

[3] His Majesty the King (the appellant) appeals from the Tax Court's award of costs on three grounds. First on the basis that the Tax Court fettered its discretion in deciding *a priori* that the costs should fall within a given range. Secondly that the Tax Court erred in principle in its treatment of three factors which are to be considered in the award of costs, namely the result of the proceeding, any settlement offer and pre-litigation conduct which prolonged the proceedings. Lastly, it submits that the Tax Court breached the appellant's right to procedural fairness in considering a factor that the parties had not raised in their submissions, without giving him the chance to make representations on that factor in coming to its conclusion.

[4] For the reasons which follow, I would allow the appeal with costs and return the matter to the trial judge for a fresh determination of the costs payable to the respondent.

II. Relevant statutory provisions

[5] In its decision, the Tax Court reviewed those factors identified in Rule 147 of the *Tax Court of Canada Rules (General Procedure)*, SOR/90-688a (the Rules) which it considered relevant. In order to give an idea of the scope of Rule 147, I reproduce all of the factors it mentions below:

147 (1) The Court may determine the amount of the costs of all parties involved in any proceeding, the allocation of those costs and the persons required to pay them.	147 (1) La Cour peut fixer les frais et dépens, les répartir et désigner les personnes qui doivent les supporter.
…	…
(3) In exercising its discretionary power pursuant to subsection (1) the Court may consider,	(3) En exerçant sa discrétion conformément au paragraphe (1), la Cour peut tenir compte :
(*a*) the result of the proceeding,	*a*) du résultat de l'instance;
(*b*) the amounts in issue,	*b*) des sommes en cause;
(*c*) the importance of the issues,	*c*) de l'importance des questions en litige;
(*d*) any offer of settlement made in writing,	*d*) de toute offre de règlement présentée par écrit;
(*e*) the volume of work,	*e*) de la charge de travail;
(*f*) the complexity of the issues,	*f*) de la complexité des questions en litige;
(*g*) the conduct of any party that tended to shorten or to lengthen unnecessarily the duration of the proceeding,	*g*) de la conduite d'une partie qui aurait abrégé ou prolongé inutilement la durée de l'instance;
(*h*) the denial or the neglect or refusal of any party to admit anything that should have been admitted,	*h*) de la dénégation d'un fait par une partie ou de sa négligence ou de son

refus de l’admettre, lorsque ce fait aurait dû être admis;

(*i*) whether any stage in the proceedings was,

i) de la question de savoir si une étape de l’instance,

(i) improper, vexatious, or unnecessary, or

(i) était inappropriée, vexatoire ou inutile,

(ii) taken through negligence, mistake or excessive caution,

(ii) a été accomplie de manière négligente, par erreur ou avec trop de circonspection;

(i.1) whether the expense required to have an expert witness give evidence was justified given

i.1) de la question de savoir si les dépenses engagées pour la déposition d’un témoin expert étaient justifiées compte tenu de l’un ou l’autre des facteurs suivants :

(i) the nature of the proceeding, its public significance and any need to clarify the law,

(i) la nature du litige, son importance pour le public et la nécessité de clarifier le droit,

(ii) the number, complexity or technical nature of the issues in dispute, or

(ii) le nombre, la complexité ou la nature des questions en litige,

(iii) the amount in dispute; and

(iii) la somme en litige;

(*j*) any other matter relevant to the question of costs.

j) de toute autre question pouvant influer sur la détermination des dépens.

[6] The liability for gross negligence in making a false statement in an income tax return arises from subsection 163(2) of the ITA:

(2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a “return”) filed or made in respect of a

(2) Toute personne qui, sciemment ou dans des circonstances équivalant à faute lourde, fait un faux énoncé ou une omission dans une déclaration, un formulaire, un certificat, un état ou une réponse (appelé « déclaration » au présent article) rempli, produit ou présenté, selon le cas, pour une année d’imposition pour l’application de la

taxation year for the purposes of this Act, is liable to a penalty …	présente loi, ou y participe, y consent ou y acquiesce est passible d'une pénalité …

[7] The provision which allows the Minister to waive or cancel a penalty, as proposed by the respondent, is subsection 220(3.1) of the ITA:

(3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.	(3.1) Le ministre peut, au plus tard le jour qui suit de dix années civiles la fin de l'année d'imposition d'un contribuable ou de l'exercice d'une société de personnes ou sur demande du contribuable ou de la société de personnes faite au plus tard ce jour-là, renoncer à tout ou partie d'un montant de pénalité ou d'intérêts payable par ailleurs par le contribuable ou la société de personnes en application de la présente loi pour cette année d'imposition ou cet exercice, ou l'annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

[8] In order to avoid repetition, I will summarize the parts of the Tax Court's reasons which are in issue in my analysis.

III. Analysis

[9] The first error which the appellant raises is the Tax Court's determination that partial indemnity costs in this case should fall in the range of 50% to 75% of the respondent's actual legal expenses. The appellant argues that this amounts to a fettering of discretion.

[10] The appellant then argues that the Tax Court misunderstood or misapplied the following items in Rule 147(3):

> (*a*) the result of the proceeding,
>
> (*d*) any offer of settlement made in writing, and
>
> (*g*) the conduct of any party that tended to shorten or to lengthen unnecessarily the duration of the proceeding.

[11] In addition, the appellant claims that the Tax Court breached its right to procedural fairness in relation to item (*g*).

[12] These then are the issues in this appeal.

[13] In their submissions on the standard of review, the parties referred to the venerable formula according to which a discretionary decision may be set aside if the tribunal (here, the Tax Court) considered irrelevant factors, failed to consider relevant factors or reached an unreasonable conclusion: appellant's memorandum of fact and law (MFL) at para. 25, respondent's MFL at para. 17. The respondent also referred to the appellate standard of review in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (*Housen*), namely correctness for

questions of law and palpable and overriding error for questions of fact or mixed fact and law, unless an extricable question of law is found, in which case correctness applies: respondent's MFL at para. 16.

[14] In *Hospira Healthcare Corporation v. Kennedy Institute of Rheumatology*, 2016 FCA 215, [2017] 1 F.C.R. 331 at paragraph 72, this Court held that the standard of review of discretionary decisions was the same as in *Housen*. Since the discretion exercised in awarding costs does not differ in kind from that exercised in other contexts, it is my view that this discretion should be reviewed on the same basis as other discretionary decisions, that is on the standard set out in *Housen*.

[15] As a result, the scope of the factors referred to in subsection 147(3) of the Rules is a question of law reviewable on the standard of correctness and the application of those factors to the facts of a case is a question of mixed fact and law, reviewable for palpable and overriding error, except in the case of an extricable error of law in which case, the correctness applies to that error.

[16] In its most recent pronouncement on the subject, the Supreme Court has held that questions of procedural fairness are legal questions to be reviewed on the correctness standard: *Law Society of Saskatchewan v. Abrametz*, 2022 SCC 29, 470 D.L.R. (4th) 328 (*Abrametz*), at paras. 26-30. The issue in that case was whether the Law Society's conduct amounted to an abuse of process. While not every instance of procedural fairness amounts to an abuse of process, every abuse of process amounts to a breach of procedural fairness: *Blencoe v. British*

Columbia (Human Rights Commission), 2000 SCC 44, [2000] 2 S.C.R. 307 at paras. 151-155 (per Lebel J. dissenting, but not on this point). As a result, any debate as to whether questions of procedural fairness are questions of law reviewable on the standard of correctness – see *Hussey v. Bell Mobility Inc.*, 2022 FCA 95, 2022 C.L.L.C. 210-052 at para. 24, *Canadian Pacific Railway Company v. Canada (Attorney General)*, 2018 FCA 69, [2019] 1 F.C.R. 121 at paras. 54-56 – has been put to rest.

[17] With these comments in mind, I now turn to the appellant's allegations of error.

A. *The Tax Court's use of a range of possible outcomes*

[18] In discussing the principles applicable to an award of costs, the Tax Court correctly held that the Court was not limited to applying Tariff B of Schedule II of the Rules. Rule 147(4) provides that:

> The Court may fix all or part of the costs with or without reference to Schedule II, Tariff B and, further, it may award a lump sum in lieu of or in addition to any taxed costs.

[19] The Court then considered the basis upon which lump sum costs, that is, partial indemnity, substantial indemnity or full indemnity, could be awarded. The Court quoted three legal texts dealing with costs. It cited Mark M. Orkin & Robert G. Schipper, *The Law of Costs*, 2nd ed. (Toronto, Ontario: Thomson Reuters, 1987) (loose-leaf updated October 2021, release 6) (*Orkin*) for the proposition "that the traditional degree of indemnification of party-to-party costs has been between 50% and 75% of solicitor-client costs or substantial indemnity costs": Decision at para. 28. The Court acknowledged that there was no binding authority that costs

should be awarded in that range. It also commented that this proposition was not universally accepted and that according to another text – Janet Walker & Lorne Mitchell Sossin, *Civil Litigation* (Toronto, Ontario: Irwin Law, 2010), traditionally partial indemnity costs fall closer to 50% while according to another text – Linda S. Abrams & Kevin Patrick McGuinness, *Canadian Civil Procedure Law*, 2nd ed. (Markham, Ontario: LexisNexis Canada, 2010), the range of partial indemnity in the Ontario courts falls between 40% and 60% of solicitor-client costs: Decision at para. 28. It can be seen from this that there is no consensus in the field as to the breadth of the range, particularly at the upper end.

[20] Citing the decision in *Guibord v. R.*, 2011 FCA 346, 2012 D.T.C. 5030, the Tax Court held that the only binding direction given to it by this Court was that quantum of costs must be reasonable and determined on a principled basis: Decision at para. 29.

[21] The Court concluded its discussion of this point as follows:

> That being said, for consistency purposes, in my view, the 50% to 75% range of solicitor-client costs should be used unless there are exceptional circumstances.
>
> Decision at para. 30

[22] The Court then reviewed the factors set out in Rule 147(3), finding that some favoured costs at the higher end of the range while others were neutral. In the end, it reviewed its conclusions on those factors and held as follows:

> In this case, the success of the [respondent] at trial and the importance of the amount at issue for the [respondent] weigh heavily in favour of an award of costs at the upper-limit of the partial indemnity costs range mentioned above.
>
> Furthermore, the importance of the issue decided by the Court, the offer to settle made by the [respondent] and the conduct of the Minister before the

> commencement of the proceeding all favour an increased partial indemnity costs award. Based on their cumulative effect, I have determined that the [appellant] should pay the [respondent] what is in my view the maximum amount of costs allowable within the applicable range, that is 75% of her incurred legal fees.
>
> Decision at paras. 90-91

[23] The appellant argues that the Court erred, by fettering its discretion, in limiting the range of costs to 50%-75% of solicitor-client costs while the respondent argues that the appellant places too much emphasis on the sequence in which the Tax Court ordered its analysis, that is, dealing with the issue of the range before examining the various relevant factors.

[24] It is true that the argument that the Court fettered its discretion arises from the fact that the Court established the range before it had even considered the factors set out in Rule 147(3).

[25] When one reviews the Tax Court's analysis of the various factors listed in Rule 147(3), it is apparent that the Court's focus is on how each factor moves the needle higher or lower in the 50%-75% range that it had previously selected. But a review of like cases undertaken after the Tax Court had addressed the various factors may have pointed to the possibility of a lower range. The fact that the possibility of a lower range was precluded by the approach taken by the Tax Court is an indicator that the Tax Court had, in fact, fettered its discretion and, in doing so, erred in law.

[26] Beyond this, the summary of the Tax Court's reasoning on the appropriate range makes it clear that the ranges it considered were not specific to the Tax Court, nor were they consistent. The Court considered three legal texts that set out different ranges. The Court acknowledged that

the range it preferred, that set out in *Orkin*, was not unanimously accepted and cited a number of Tax Court cases that awarded costs that fell outside that range: *Paletta Estate v. The Queen*, 2021 TCC 41, 2021 D.T.C. 1032 (45%), *Damis Properties Inc. v. The Queen*, 2021 TCC 44, 2021 D.T.C. 1038 [*Damis*] (35%), *Cameco Corporation v. The Queen*, 2019 TCC 92, 2019 D.T.C. 1066 (35%), *CIT Group Securities (Canada) Inc. v. The Queen*, 2017 TCC 86, 2017 D.T.C. 1050 (36%), *Invesco Canada Ltd. v. R.*, 2015 TCC 92, [2015] G.S.T.C. 52 (40%), *Klemen v. R.*, 2014 TCC 369, 2015 D.T.C. 1040 (30%).

[27] The Tax Court recognized that costs must be awarded on a principled basis (Decision at paras. 22, 29, 34) which implies that the award must not be arbitrary: *Delta Air Lines Inc. v. Lukács*, 2018 SCC 2, [2018] 1 S.C.R. 6 at para. 45, *Mohammad v. Canada (C.A.)*, 1997 CanLII 6356 (F.C.A.), [1998] 1 F.C. 165 at para. 30, *Monsanto Canada Inc. v. Janssens*, 2009 FC 318, 343 F.T.R. 234 at para. 52.

[28] The Tax Court's selection of the 50% to 75% range was made in the name of consistency. Unfortunately, the sources cited showed no consistency. Assuming that the Court had in mind that its award should be consistent with other decisions of the Tax Court, it is notable that it did not cite other costs decisions of the Tax Court to demonstrate that the amount which it awarded was consistent with what had been done in other cases.

[29] The Tax Court was right to advance consistency as a basis upon which to base an award of costs but it erred in principle in not addressing the Court's own jurisprudence in setting a range of possible awards. The Court's own jurisprudence is important because a lack of

consistency in the treatment of comparable cases leads to arbitrary results: see *Teva Canada Ltd. v. TD Canada Trust*, 2017 SCC 51, [2017] 2 S.C.R. 317 at para. 138, *Sriskandarajah v. United States of America*, 2012 SCC 70, [2012] 3 S.C.R. 609 at para. 18.

[30] Consistency is important for another reason. A consistent approach to costs leads to predictability. Litigants' decision-making is improved if they are able to assess, to a reasonable degree, the potential quantum of costs to which they may be exposed in the event of an adverse result. To the extent that a secondary purpose of costs is to encourage proportionality and advance settlements (Decision at para. 19), a reasonable grasp of one's potential exposure to costs can only assist in achieving those purposes.

[31] This is not to say that a judge awarding costs on a lump sum basis must conduct a statistically sound review of prior costs awards to arrive at an appropriate amount. It simply means that a decision as to an appropriate award of costs must be grounded in the Court's past practice and jurisprudence. A good example of this approach can be found in *Damis*. In the case at bar, an analysis of, or reference to, cases with comparable facts would have provided useful guidance on an appropriate level of costs.

[32] It is important to note that this approach is simply a means by which the broad discretion available to judges in awarding costs can be exercised in a principled, non-arbitrary manner.

B. *The result of the proceeding - Rule 147(3)(a)*

[33] After having established that the range of partial indemnity was 50% to 75% of a party's solicitor-client costs, the Tax Court reviewed the various factors listed in Rule 147(3) of the Rules, beginning with the factor found at Rule 147(3)(*a*): the result of the proceeding. The Court noted that the result of the proceeding could affect the award of costs in two ways. In the first instance, it determines who, in the normal course, is entitled to costs, which, normally, is the successful party.

[34] In describing the second way in which success could affect the award of costs, the Court first quoted *Lux Operating Limited Partnership v. The Queen*, 2018 TCC 214, 2018 D.T.C. 1156 (*Lux*), which was relied upon by the respondent in this Court:

> In my view, when determining the quantum of costs to be awarded, the result of the proceeding is only an appropriate factor to consider if it is possible for a party to have had mixed success in the proceeding. … If a proceeding involves a single issue over which there are a number of different potential outcomes (e.g. a valuation issue), the degree of a party's success on that issue will be relevant to the quantum of costs. However, when the only issue before the Court is a black-or-white issue on which there is no potential for partial success, the fact that a party succeeded on that issue should not, in my view, affect the quantum of costs awarded. The party achieved success. That success was no better or worse than what the party could have hoped to achieve and thus neither argues for higher nor lower costs.
>
> *Lux* at para. 10 (my emphasis).

[35] Having cited this passage from *Lux*, the Tax Court proceeded to take a position at odds with it, namely that where a party faced an "all or nothing issue", the level of success could be taken into consideration by the Court in fixing the amount of costs. In the end, the Court found that the respondent's case was of the black or white variety, in which she had achieved 100%

success, a result which the Court found weighed heavily in favour of increased costs: Decision at paras. 51-52.

[36] It is true that the respondent's success in persuading the Court that she was not grossly negligent was a factor that could be taken into consideration by the Court, but only on the issue of her entitlement to costs. The reason for this is that the factors which might favour an increase (or decrease) in a successful party's costs are set out in the remaining factors identified in Rule 147(3). Awarding costs on the basis of the result and then enhancing those costs on the basis of the result is double counting that factor. The Tax Court erred in law in defining the scope of this factor.

[37] In addition, the Tax Court's conclusion is, as noted, at odds with the passage which it quoted from *Lux* to the effect that success in an all or nothing case should not affect costs. That said, while the decision in *Lux* was not binding on the Court, the doctrine of judicial comity would require the Court to justify its departure from the finding of another judge of the Tax Court on the same question: *R. v. Sullivan*, 2022 SCC 19, [2022] S.C.J. No. 19 at paras. 73-75. The failure to do so was also an error of law.

C. *Any offer of settlement made in writing - Rule 147(d)*

[38] Prior to trial, the respondent made an offer to settle the matter on the following terms:

> 1. The Minister of National Revenue ("Minister") will reassess her 2010 taxation year so as to:
>
> > (a) vacate the penalties assessed under subsection 163(2) of the *Income Tax Act* R.S.C., 1985 c. 1 (5th Supp.) (the "Act") and

> section 38(1) of the *Income Tax Act* (British Columbia), R.S.B.C. 1966, c. 215 by the notice of assessment dated June 12, 2014; and
>
> (b) assess a penalty in the amount of $2,500 under paragraph 162(7)(b) of the Act in respect of the [respondent's] failure to comply with her duty or obligation under the Act to prevent the filing of the Amended Return (defined below); and [sic]

[39] This text was taken from counsel's letter at pages 52-61 of the Appeal Book setting out the respondent's settlement offer. The numeral 1 opposite the first sentence and the presence of "and" at the conclusion of paragraph (b) of the offer suggest that there is more to it than appears on page 52. Unfortunately, page 53 does not resolve the issue but immediately sets out the respondent's explanation of her settlement offer. However, in a later part of the letter (at page 60 of the Appeal Book), it is said that the offer was made on a "without costs" basis. This leads to the conclusion that, in return for the concessions sought in paragraph 1, Mrs. Bowker offered to waive her costs.

[40] It is important to note that the respondent also proposed an alternate basis for settlement in the form of a request pursuant to subsection 220(3.1) of the ITA that the Minister cancel the penalty assessed under subsection 163(2). I will address the respondent's principal offer first and then her alternate offer.

[41] Subsection 162(7) of the ITA reads as follows:

(7) Every person (other than a registered charity) or partnership who fails	(7) Toute personne (sauf un organisme de bienfaisance enregistré) ou société de personnes qui ne remplit pas une déclaration de renseignements selon les modalités et dans le délai prévus par la présente loi ou le Règlement de l'impôt sur le

(*a*) to file an information return as and when required by this Act or the regulations, or	revenu ou qui ne se conforme pas à une obligation imposée par la présente loi ou ce règlement est passible, pour chaque défaut 00 sauf si une autre disposition de la présente loi (sauf les paragraphes (10) et (10.1) et 163(2.22)) prévoit une pénalité pour le défaut — d'une pénalité égale, sans être inférieure à 100 $, au produit de la multiplication de 25 $ par le nombre de jours, jusqu'à concurrence de 100, où le défaut persiste.
(*b*) to comply with a duty or obligation imposed by this Act or the regulations	
is liable in respect of each such failure, except where another provision of this Act (other than subsection 162(10) or 162(10.1) or 163(2.22)) sets out a penalty for the failure, to a penalty equal to the greater of $100 and the product obtained when $25 is multiplied by the number of days, not exceeding 100, during which the failure continues.	

[42] The law as to settlements in the income tax context is relatively settled. The following passage from *Galway v. M.N.R.*, 1974 CanLII 2465 (FCA), [1974] 1 FC 600 (*Galway*) at page 602 is the classic formulation of the principle:

> […] the 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 and that, when the Trial Division, or this Court on appeal, refers an assessment back to the Minister for re-assessment, it must be for re-assessment on the facts in accordance with the law and not to implement a compromise settlement.
>
> See also *CIBC World Markets Inc. v. Canada*, 2012 FCA 3, [2012] F.C.J. No. 30 at paras. 22-24, *Canada (Attorney General) v. Collins Family Trust*, 2022 SCC 26 at para. 26.

[43] The Tax Court found that the respondent's offer of settlement was principled because she "recognized having committed a breach in her duty not to make false statements in her tax returns": Decision at para. 63. This is not accurate, as the respondent only conceded that "her

failure to adequately monitor and make inquiries of an authorized representative … could constitute a failure to comply with her duty under the Act not to allow the filing of false statements in a return": Appeal Book at 59. The respondent did not concede that she had been negligent, only that she could have been.

[44] In any event, the respondent argued that her negligence made her liable for the lesser penalty set out in subsection 162(7) of the ITA. The respondent further argued that, since there was no other provision of the ITA which provided a penalty for negligently making false statements in an income tax return, paragraph 162(7)(*b*) applied.

[45] The question of whether paragraph 162(7)(*b*) applies is a question of statutory interpretation. It is settled law that a statute must be interpreted according to its text, context, and purpose: *Canada (Canadian Human Rights Commission) v. Canada (Attorney General*), 2011 SCC 53, [2011] 3 S.C.R. 471 at paras. 32-33, *Society of Composers, Authors and Music Publishers of Canada v. Entertainment Software Association*, 2022 SCC 30, [2022] S.C.J. No. 30 at paras. 8-9.

[46] It is true that the words of paragraph 162(7)(*b*) are broad enough to include negligence in the preparation of an income tax return, assuming that such an obligation exists. Not every error in an income tax return is the result of negligence since, given the complexity of the ITA, errors can result from a simple misapprehension of the requirements of the legislation or from an incorrect appreciation of the relevance of the facts. On the other hand, it is likely that some errors are the result of the failure to take reasonable care in the preparation of an income tax return.

However, it is significant that Parliament has chosen to penalize only negligence which is sufficiently egregious to merit the vituperative epithet of “gross negligence”.

[47] What does the context within which section 162(7) generally, and paragraph 162(7)(*b*) in particular, are found, tell us about the interpretation of those provisions? Section 162 deals with penalties for failures in relation to filing returns or failing to provide information as and when required. Paragraph 162(7)(*a*) addresses the failure to file an information return as and when required, whereas paragraph 162(7)(*b*) addresses the failure to comply with a duty or obligation imposed by the ITA or the regulations.

[48] The question which arises is why a penalty of very broad application (assuming the interpretation proposed by the respondent) would be tucked away in a paragraph within a subsection dealing with a specific failure to file certain documents. This question can be answered in part by reference to the canon of construction known as *noscitur a sociis*:

> Counsel for the respondent submits that this finding can be justified by the rule of interpretation *noscitur a sociis*. According to that rule, “[a]n expression's meaning may be revealed by its association with others” and where general and specific words are associated together and are capable of analogous meaning, the general words should be restricted to the specific meaning unless this would be contrary to the clear intention of Parliament.
>
> *Vancouver Art Metal Works Ltd v. Canada (C.A.)*, 1993 CanLII 2930 (FCA), [1993] 2 F.C. 179 at 185. See also *McDiarmid Lumber Ltd. v. God's Lake First Nation*, 2006 SCC 58, [2006] 2 S.C.R. 846 at para. 30

[49] Following this principle, the scope of paragraph 162(7)(*b*) would be limited by the general tenor of section 162 dealing with various failures to file returns or to provide information and the specific context of paragraph 162(7)(*a*) dealing with the failure to file information

returns. In other words, the general language of paragraph 162(7)(*b*) would be limited to instances of failure to file returns or to provide information not specifically enumerated in the balance of section 162.

[50] This interpretation is confirmed by the manner in which the penalty for non-compliance is calculated. It will be recalled that the penalty is the greater of $100 or the product obtained when $25 is multiplied by the number of days, not exceeding 100, during which the failure continues. This formula, and a closely related one which includes payment of a percentage of the tax otherwise payable, are used in most other provisions in which the default being penalized is a failure to file (or late filing): see subsections 162(1), 162(2), 162(2.1), 162(7.1), 162(8) and 162(10). The nature of the penalty set out in subsection 162(7) strongly suggests that the duty or obligation referred to in paragraph 162(7)(*b*) is one to which the passage of time is material, such as in the case of late filing or non-filing of required returns or failing to provide required information.

[51] As a result, the context of paragraph 162(7)(*b*) strongly suggests that the general words which appear there should be interpreted more narrowly than proposed by the respondent.

[52] The purpose of paragraph 162(7) generally is to serve as an inducement to taxpayers and others to provide the information which they are required to provide in a timely manner. The time factor in the calculation of the penalty incentivizes delinquent taxpayers to file promptly, to avoid the increase of the penalty over time.

[53] As a result, I am of the view that, notwithstanding the broad words of paragraph 162(7)(*b*), it is limited to obligations to file returns or to provide information as and when it is required. This means that it would not apply to the case of returns that were filed when required but were negligently prepared. That being the case, the respondent's settlement proposal was not one which the Minister could have accepted as the lower penalty under paragraph 162(7)(*b*) was not available to the respondent.

[54] There is another basis upon which the proposal made by the respondent was not principled. Neither the respondent nor the Tax Court cited jurisprudence in which a taxpayer was assessed a penalty for negligently making a false statement in an income tax return, let alone for the possibility of having otherwise been negligent in the preparation of an income tax return. While it is apparent that taxpayers should not be negligent in the preparation of their income tax returns, if only for their own protection in avoiding unexpected assessments or reassessments and accumulated interest, Parliament has not chosen to penalize simple negligence. Mrs. Bowker's proposal invited the appellant to penalize conduct which Parliament had not penalized so that she might offer a compromise settlement.

[55] The respondent carefully invited the appellant to draw that conclusion that she was negligent even though she was not prepared to admit that she had in fact been negligent, only that she could have been. In those circumstances, the respondent's offer consisted of pointing out the weaknesses of the appellant's case and offering him a compromise based upon the possibility of her liability for a lesser penalty.

[56] In those circumstances, it is difficult to see how the respondent's offer could be principled.

[57] The respondent's alternate submission was that the matter could be settled on the basis of the Minister's cancellation of the penalty assessed under subsection 163(2) of the ITA pursuant to subsection 220(3.1) of the ITA. That provision reads as follows:

(3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.	(3.1) Le ministre peut, au plus tard le jour qui suit de dix années civiles la fin de l'année d'imposition d'un contribuable ou de l'exercice d'une société de personnes ou sur demande du contribuable ou de la société de personnes faite au plus tard ce jour-là, renoncer à tout ou partie d'un montant de pénalité ou d'intérêts payable par ailleurs par le contribuable ou la société de personnes en application de la présente loi pour cette année d'imposition ou cet exercice, ou l'annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

[58] The basis of the respondent's request was that the penalty was grossly excessive, disproportionate and overly punitive: Appeal Book at 59-60.

[59] The penalty imposed by subsection 163(2) is not a discretionary penalty which can be imposed or not in the Minister's discretion. It is a statutory penalty which applies if it is found

that a person has knowingly or in circumstances amounting to gross negligence, made, or acquiesced in the making of, a false statement in an income tax return.

[60] Bearing in mind that the appellant must proceed "on the facts in accordance with the law and not to implement a compromise settlement" (*Galway* at 602), we must assume that in assessing the respondent in the way he did, the appellant's view was that the facts and the law, as he knew or understood them, justified the conclusion that the respondent's conduct in relation to her income tax return amounted to gross negligence.

[61] As long as the appellant was satisfied that the respondent had been grossly negligent, he was bound to give effect to the statutory penalty. If he was not satisfied, his obligation was to vacate the assessment and not to substitute a lesser non-statutory penalty. This is true even if the Minister, while being convinced of the respondent's gross negligence, believed that the penalty was too harsh in all the circumstances. This is so because the penalty is prescribed by law. It is not for the Minister to rewrite the law so as to temper its harshness.

[62] On the other hand, once the Court finds that the taxpayer was grossly negligent and dismisses the appeal (or if the taxpayer abandons the appeal), the Minister can subsequently waive or cancel the gross negligence penalty, in whole or in part, for various reasons having to do with the taxpayer's personal circumstances. It is at this point that considerations of excessiveness and disproportionality may be given effect. This respects Parliament's intention in imposing a non-discretionary penalty for gross negligence while respecting the Minister's discretion to cancel the penalty as provided in subsection 220(3.1). In cancelling the penalty, the

Minister is engaged in administering the penalty and not in modifying the legal consequences of the taxpayer's gross negligence.

[63] Given that the matter proceeded to trial, we must presume that, notwithstanding the respondent's offer of settlement, the appellant remained convinced that she had acted in a grossly negligent way in relation to false statements in her income tax return.

[64] The Tax Court's detailed enumeration of the many ways in which the Minister could have satisfied himself that the respondent was not negligent, does not change this result. The principle in *Galway* rests on the Minister's view of the facts and the law, not on what the Minister's view might have been.

[65] The result is that the respondent's settlement offer was not a principled offer in the sense that it was not one which the appellant could accept, having regard to the facts as he knew them and the law as he understood it. As a result, the failure to accept the offer was a neutral factor in the determination of the appropriate award of costs.

[66] That said, it is important to point out that it would have been possible for the appellant to have agreed to a settlement of the respondent's appeal, though not on the basis proposed by the respondent. Rather than filing a notice of appeal, the respondent could have approached the Minister with a request to waive some portion of the penalty, based on her personal circumstances.

[67] The fact that the respondent appealed the reassessment did not mean that she could no longer apply for a waiver; it just made it a little more complicated. The respondent could offer to abandon her appeal without costs – thereby conceding the issue of gross negligence – on the basis that the Minister would consider her request for a waiver of some portion of the penalty. The complication is that the waiver could only be based on the respondent's personal circumstances. It is not open to the Minister to waive some portion of the penalty on the basis of his estimate of his chances of success in the litigation as this amounts to an unprincipled compromise for the sake of a settlement. The question of gross negligence is a binary one. Either the respondent was guilty of gross negligence or she was not. If the appellant has doubts about the strength of his case, he must either proceed with the litigation or vacate the assessment. He cannot "split the difference" by reducing the penalty. At paragraph 67 of its reasons, the Tax Court found that since the "[respondent's] settlement offer was more favourable to the [appellant] than the result obtained at trial, this weighs in favour of an increased assessment of costs". While this might be the case if the offer was one capable of acceptance by the Minister, it has no application to cases where, as here, the offer is not capable of acceptance.

[68] As a result, the Tax Court's conclusion that the appellant's failure to accept the respondent's offer of settlement justified an increase in costs, contained an extricable error of law, namely the scope of paragraph 162(7)(*b*), and was therefore reviewable on the standard of correctness.

D. *Pre-litigation conduct and breach of procedural fairness*

[69] The Tax Court devoted 12 paragraphs of its reasons to the failure of the Minister's representatives to interview the respondent before the commencement of the proceedings. The Tax Court's view was that this failure was conduct prior to the litigation that prolonged the proceeding and that weighed heavily in favour of increased costs.

[70] It is not contentious that the parties did not raise the issue of pre-litigation conduct in their submissions and that the Tax Court did not advise them of its intention to pursue this line of inquiry. The appellant argues that the Tax Court breached the duty of procedural fairness in depriving him of the opportunity to address this matter before the Court relied upon it as a factor justifying an increase in costs. The respondent argues that, even if the appellant's right to procedural fairness was breached, it was not a palpable and overriding error and so, does not justify the Court's intervention.

[71] The respondent's argument does not take into account the Supreme Court's decision in *Abrametz* that questions of procedural fairness are questions of law to be assessed on the standard of correctness: *Abrametz* at paras. 26-30.

[72] One must be careful about finding a breach of procedural fairness when a court addresses one factor in a list of factors which are relevant to the result of the proceeding. In this case, both parties were no doubt aware that the Tax Court was entitled to work its way down the list of factors in Rule 147(3) and that it was not unusual for the Court to touch upon factors which were

not specifically pleaded by the parties. The inclusion of factors such as "any other matter relevant to the question of costs" – Rule 147(3)(*j*) – is the door through which such considerations arrive. There are two circumstances which take this case out of the normal course of events.

[73] The first is the Tax Court's view of the scope of "other matters which are relevant to the question of costs". The Tax Court cited this Court's decision in *Canada v. Martin*, 2015 FCA 95 (*Martin*) as authority for the proposition that "in exceptional circumstances, a Court can consider a party's conduct prior to a proceeding if that conduct unduly and unnecessarily lengthen [sic] the proceeding": Decision at para. 78.

[74] The paragraph in *Martin* upon which the Tax Court relied reads, in its material parts, as follows:

> In exercising its discretion on costs the Tax Court may consider a number of factors, including the conduct of any party that tended to shorten or to lengthen unnecessarily the duration of the "proceeding" (Rule 147(3)(*g*)) and whether any stage in the "proceeding" was improper, vexatious or unnecessary (Rule 147(3)(*i*)(i)). The Tax Court has discretion to award or refuse costs in respect of a "part of a proceeding" (Rule 147(5)(*a*)).
>
> *Martin* at para. 21

[75] With respect, this passage does not authorize an inquiry into pre-litigation conduct. The Tax Court dealt with Rule 147(3)(*g*) earlier in its reasons and found that the conduct of counsel did not affect the duration of the proceedings. As for Rule 147(3)(*i*)(i), it is of no assistance to the Tax Court as it deals with whether "any stage in the proceeding was … unnecessary". Proceeding is a defined term which means "an appeal or reference". It follows that pre-litigation

conduct is not a stage in the proceeding. In the circumstances, the appellant cannot be faulted for failing to recognize that the Tax Court would consider pre-litigation conduct in assessing costs.

[76] The second factor is that the appellant had information which was relevant to the issue of his agents' ability to interview the respondent, namely that there was documentary evidence that the respondent would only deal with the appellant in writing. As a result, the ability to interview the respondent as well as the results of such an interview are speculative.

[77] A finding of breach of procedural fairness renders a decision liable to be overturned: *Cardinal v. Kent Institution*, 1985 CanLII 23 (SCC), [1985] 2 S.C.R. 643 at para. 23, *Université du Québec à Trois-Rivières v. Larocque*, 1993 CanLII 162 (SCC), [1993] 1 S.C.R. 471 at 493. However, a court may exercise its discretion to not grant a remedy for breach of procedural fairness where the result is inevitable: *Mobil Oil Canada Ltd. v. Canada-Newfoundland Offshore Petroleum Board*, 1994 CanLII 114 (SCC), [1994] 1 S.C.R. 202 at 228-229, *Rebello v. Canada (Justice)*, 2023 FCA 67 at para. 16.

[78] While the issue of pre-litigation conduct was but one of several factors which the Tax Court considered in awarding costs, it was one of a smaller number of factors weighing heavily in favour of increased costs: Decision at paras. 90-91. Some of those factors, notably the respondent's success at trial, the applicable range of partial indemnity awards, and the respondent's offer of settlement, have been found to be either incorrectly understood or incorrectly applied. As a result, it cannot be said that the result upon reconsideration is inevitable.

[79] As a result, this breach of procedural fairness justifies remitting the matter to the Tax Court for reconsideration.

IV. Conclusion

[80] In summary, I find that the Tax Court breached the parties' right to procedural fairness in not giving them notice of its intention to address pre-litigation conduct as a factor in awarding costs. This deprived the appellant of the opportunity to bring relevant facts to the Court's attention. This failure justifies setting aside the Tax Court's award of costs and returning the matter to the trial judge for reconsideration.

[81] The Tax Court also erred in law in fettering its discretion as to the range of partial indemnity, the effect of success at trial, and in its conclusion that the respondent's offer to settle was principled. These errors would also justify returning the matter to the Tax Court. In making a fresh determination of the respondent's entitlement to costs, the Tax Court should act in accordance with the principles set out in these reasons.

[82] I would therefore allow the appeal with costs, set aside the Tax Court's judgment and return the matter to the trial judge for a fresh determination of the costs payable to the respondent.

"J.D. Denis Pelletier"
J.A.

"I agree.
Yves de Montigny J.A."

"I agree.
Mary J.L. Gleason J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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