Settlement, Compromise, and Forgiveness in Canadian Income Tax Law

by

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Submitted in partial fulfilment of the requirements for the degree of Master of Laws

at

Dalhousie University
Halifax, Nova Scotia
August 2013

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ABSTRACT

This thesis looks at legal mechanisms allowing the non-collection of tax debts in the tax systems of Canada and the United States. The goal is to shed light on the choices made in Canada's tax collection system by juxtaposing it with the American system. The comparison reveals differences in the ways in which the two jurisdictions allow taxpayers to participate in the tax system and differences in how the two jurisdictions choose to make decisions about the forgiveness of tax debts. Although Canada has generally rejected the idea of compromise within the tax system, there is a tax policy case to be made in favour of the compromise of tax debts in certain situations.

ACKNOWLEDGEMENTS

I would like to express my sincere thanks to all those who read and commented on earlier versions of this thesis or its chapters. Geoffrey Loomer and Faye Woodman read drafts of the entire thesis and provided valuable feedback. I was also helped greatly during the early stages of the project by the participants in the 2012-13 Graduate Seminar on Legal Education and Legal Scholarship at the Schulich School of Law at Dalhousie University. I am grateful for all of the support and encouragement offered by those involved in the graduate program. My supervisor, the indefatigable Kim Brooks, has been constant source of advice, support, and encouragement throughout the development and execution of this project, and any success I have had is owing to her. Needless to say, errors and omissions in the work that follows are my own.

Finally, I wish to thank my family whose patience, support, and faith made this project possible.

CHAPTER 1: INTRODUCTION

> Then tax collectors also came to be baptized, and said to him, "Teacher, what shall we do?" And he said to them, "Collect no more than what is appointed for you."[1]

> I shall risk this proposition: each time forgiveness is at the service of a finality, be it noble and spiritual (atonement or redemption, reconciliation, salvation), each time that it aims to re-establish a normality (social, national, political, psychological) by a work of mourning, by some therapy or ecology of memory, then the 'forgiveness' is not pure – nor is its concept. Forgiveness is not, it *should not be*, normal, normative, normalising. It *should* remain exceptional and extraordinary, in the face of the impossible: as if it interrupted the ordinary course of historical temporality.[2]

The aims of this thesis are to look at situations in which the tax authorities in Canada are willing to accept less than the full amount assessed under the *Income Tax Act*, those in which they are forbidden from doing so, and those in which accepting less than the full amount might further the goals of the income tax system.[3] To illuminate the Canadian approach on these issues, I compare it with that of the United States. In this introductory chapter, I explain my approach to analysis, expand upon the goals of the project, and provide a brief overview of each of the four substantive chapters of the thesis.

I use several terms interchangeably throughout this thesis. In discussing the settlement, compromise, and forgiveness of tax debts, I am, in each case, referring to some situation in which the tax authority accepts less that it believes the government is owed. A tax debt is forgiven; a tax dispute is settled; a tax assessment is compromised. I

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[1] Luke 3:12-13 (New King James Version). I am not aware of John the Baptist providing any direction about accepting less than "what is appointed".

[2] Jacques Derrida, *On Cosmopolitanism and Forgiveness*, translated by Mark Dooley & Michael Hughes (New York: Routledge, 2001) at 31–32 [emphasis in original].

[3] *Income Tax Act*, RSC 1985, c 1 (5th Supp) [*ITA*].

choose these three terms, each with a slightly different connotation, to describe the same action to highlight the idea that we might see the action in different ways. Forgiveness has overtones of the Abrahamic faiths, but is also thought of as a secular virtue.[4] Compromise can have both positive and negative connotations – compromise to resolve a dispute verses a compromise of one's principles.[5] Settlement is similar to compromise, but with perhaps fewer negative connotations, and an increased sense of finality.[6] While I do not undertake any deeper analysis of the linguistics of the question, my intention is to highlight the fact that there are several ways that we might think about the non-collection of a tax liability.

In addition to exploring different approaches to the question, which I explain further below, my goal is, in part, to make an attempt to contribute to the relatively thin academic literature on tax administration in Canada. To date, both tax law scholars and administrative law scholars have left Canada's tax administration largely overlooked.[7] Others have looked at cultures of tax collection in other jurisdictions, administrative issues in tax generally, and even questions around the justifications for compromise in the American context.[8] In Canada, however, there is still work to be done in developing the discussion of tax administration.[9]

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[4] Charles L Griswold, *Forgiveness: A Philosophical Exploration* (New York: Cambridge University Press, 2007) at xv.

[5] Merriam-Webster provides two alternative definitions for "compromise", as follows: "settlement of differences by arbitration or by consent reached by mutual concessions", and, "a concession to something derogatory or prejudicial <a compromise of principles>" (Merriam-Webster, online: <http://www.merriam-webster.com>.

[6] Among the definitions of "settle", are the following: "to fix or resolve conclusively"; "to conclude (a lawsuit) by agreement between parties usually out of court"; and "to close (as an account) by payment often of less than is due" (Merriam-Webster, *ibid*.)

[7] See similar comments in Lorne Mitchell Sossin, *Revenue, Ideology, and Legitimacy: The Politics of Tax Administration in Canada* (PhD Thesis, University of Toronto, 1992) [unpublished] at 9. I suggest that the situation is largely the same today.

[8] Ann Mumford, *Taxing Culture: Towards a Theory of Tax Collection Law* (Aldershot: Ashgate, 2002); Bryan T Camp, "Theory and Practice of Tax Administration" (2009) 29 Va Tax Rev 227; Bryan T Camp,

Part of the reason for taking a comparative approach to the question was to allow me to tap into the broader and deeper bodies of scholarship that are found in other jurisdictions. The comparative approach I employ might be considered a functionalist one, in that I look at the approaches of two jurisdictions to a question that, arguably, all tax systems will be forced to answer: when, if ever, should the tax authority accept less than the amount of the liability calculated in the normal course of the operation of the tax system?[10] However, the functionalist approach is open to a number of criticisms. The functionalist relies on the questionable assumption that the law is called upon to resolve the same social issues in different legal systems.[11] Moreover, functionalism generally focuses only on law's practical consequences as comparable results, largely ignoring

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"Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998" (2004) 56 Fla L Rev 1; Bryan T Camp, "The Failure of Adversarial Process in the Administrative State" (2009) 84 Ind L J 57; Shu-Yi Oei, "Getting More by Asking Less: Justifying and Reforming Tax Law's Offer-in-Compromise Procedure" (2012) 160:4 U Pa L Rev 1071 [Oei, "Getting More"]; Shu-Yi Oei, "Who Wins When Uncle Same Loses? Social Insurance and the Forgiveness of Tax Debts" (2012) 46:2 UC Davis L Rev 421 [Oei, "Social Insurance"].

[9] While highlighting some gaps in the academic literature around tax administration in Canada, I would not want to be understood to be disparaging the valuable work that has been done directed at academics and practitioners, many of which I draw on in this thesis. See, for example: Canada, *Report of the Royal Commission on Taxation* (Ottawa: Queen's Printer, 1966) [*Carter Report*], vol 5, part B. Colin Campbell, *Administration of Income Tax 2012* (Toronto: Carswell, 2012) [Campbell, *Administration 2012*]; David Robertson et al, *Couzin Taylor's Guide to Canadian Income Tax Administration* (Toronto: Ernst &Young, Canadian Institute of Charter Accountants, 2011); Daniel Sandler & Colin Campbell, "Catch-22: A Principled Basis for the Settlement of Tax Appeals" (2009) 57:4 Can Tax J 25; *2012 Tax Dispute Resolution, Compliance, and Administration Conference Report* (Toronto: Canadian Tax Foundation, 2013) [*2012 Tax Dispute Resolution, Compliance, and Administration Report*] ; Colin Campbell & Maureen Berry, "Back to the Future: Is It Time To Put Revenue Canada into Commission?" (1995) 43:6 Can Tax J 1901; Colin Campbell, "Access to Justice in Income Tax Appeals" (2012) 63 UNBLJ 445; as well as several essays in Kim Brooks, ed, *The Quest for Tax Reform Continues: The Royal Commission on Taxation Fifty Years Later* (Toronto: Carswell, 2013) [Brooks, *Fifty Years Later*] [forthcoming].

[10] The leading account of functionalism is often taken to be the introductory chapter of Konrad Zweigert & Hein Kötz, *Introduction to Comparative Law*, 3d ed, translated by Tony Weir (Oxford: Clarendon Press, 1998) at 32–47, which first appeared in 1977 in the first edition of that book. See also: Ralf Michaels, "The Functional Method of Comparative Law" in Reinhard Zimmermann & Mathias Reimann, eds, *The Oxford Handbook of Comparative Law* (Oxford: Oxford University Press, 2006) 339; Richard Hyland, "Comparative Law" in Dennis Patterson, ed, *A Companion to Philosophy of Law and Legal Theory* (Cambridge, MA: Blackwell, 1996) 184 at 187–90.

[11] Hyland, *supra* note 10 at 189.

context for the sake of focusing on function.[12] It also assumes that different legal systems will reach similar results (though perhaps by different means), encouraging reductionism.[13]

However, my goals for the comparative analysis in this thesis are modest. The hope is not to unearth a common or best solution – to search for a universal or general law as comparativists are sometimes accused of doing.[14] I aim to shed some light on the approaches to the settlement, compromise, or forgiveness of tax debts chosen by the designers of the Canadian tax system. In pursuing this goal, two difficulties arise that can be mitigated by the use of a comparative approach. First, there may be a tendency to think of our chosen approach as "universal or 'inevitable' in nature".[15] Our tax system is complex, and, as a result, those who study it spend a fair amount of time and energy understanding and rationalizing it.[16] The result, in some cases, is a constrained ability to imagine how things could be different. Second, Canada's approach to compromise in the tax system is restrictive. Where the rule is fairly stark and simple – "no compromise" – one way to illuminate both the norms underlying such a rule and its consequences is to imagine an alternative. However, the complexity and scale of the tax system in Canada mean that a myriad of potential sites for forgiveness of taxpayers might be imagined, and a wide variety of schemes might be designed to allow for forgiveness.

Fortunately, there is no need to invent an alternative out of whole cloth. The United States takes a markedly different approach to these issues, and a juxtaposition of

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[12] *Ibid* at 188.
[13] *Ibid* at 190.
[14] Gunter Frankenberg, "Critical Comparisons: Re-thinking Comparative Law" (1985) 26 Harv Int'l L J 411 [Frankenberg, "Critical Comparisons"] at 440; Hyland, *supra* note 10 at 186–87.
[15] Michael A Livingston, "Law, Culture, and Anthropology: On the Hopes and Limits of Comparative Tax" (2005) 18 Can JL & Jur 119 at 123.
[16] Charlotte Crane, "The Income Tax and the Burden of Perfection" (2006) 100 Nw U L Rev 171.

the two systems will be revealing. Moreover, the comparison need not be overly reductive. I do pay some attention to context, though it would be impossible to fully explore the legal and cultural contexts in which the two tax systems operate. While cultural differences between Canada and the United States may explain the differences in approach to this issue, there is a sense in which the two countries share a similar conversation as it relates to tax.

Where the goal is, as Michael Livingston has suggested, appreciating one's own culture by being exposed to another, much of the criticism of comparative functionalism loses its sting (or, perhaps, the project ceases to be functionalism in its pure form).[17] Difference need not be assumed away and context need not be ignored. Moreover, many of the assumptions of functionalism appear to be true in this case: modern, industrialized countries with developed income tax systems will choose to incorporate outlets for compromise and forgiveness into their tax systems or will decide against doing so. The consequences of this choice, at least in the Canadian context, are worth exploring.

Demonstrating that question is worth exploring is the focus of the second chapter of this thesis. There I lay out some of the historical evolution of the rules that forbid compromise in the Canadian tax system. I also briefly explain the American approach that I will use throughout the thesis to provide juxtaposition for the Canadian rules. I suggest that the academic literature has given relatively little consideration to these issues, and note that the influential *Report of the Royal Commission on Taxation* suggested a different course for the Canadian tax system.[18] I argue that, while the Canadian approach appears on the surface to be in line with our tax policy goals, there

[17] Livingston, *supra* note 15 at 123.
[18] *Carter Report*, *supra* note 9.

are reasons to look more closely at how the rules operate and to consider alternative approaches.

The Canadian approach is one that generally refuses to compromise, either to settle a tax dispute or for the purposes of collecting part of a debt. The *Income Tax Act* gives the Minister of National Revenue the power to forgive interest and penalties, but this power does not extend to the core of the tax liability assessed. On the surface, this seems to reflect a concern for equity between taxpayers. On this view, equity requires that each taxpayer is assessed according to the established rules, and that each taxpayer be required to pay the tax assessed in full. However, I suggest that there are reasons to believe that strict enforcement of these rules may, at times, create inequity, and that compromise is worth exploring as a way to mitigate inequity that exists in the tax system.

In chapter 3, I look closely at the administrative processes that Canada and the United States use to compromise tax liability.[19] These include statutory provisions, administrative guidelines, and principles applied on judicial review of administrative action in the two countries. In particular, I examine the following: the American offer-in-compromise program which allows the partial forgiveness of tax debts; the Canadian taxpayer relief provisions, which allow the forgiveness of interest and penalties but not taxes; and the Canadian "principled basis" doctrine, which forbids the tax authorities from compromising for the purpose of settling a tax dispute.

After examining the details of these mechanisms, I draw on the taxonomy of legal processes developed in the work of Lon Fuller and I argue that Canada's tax system uses adjudicative processes and eschews contractual bargaining processes. This observation

[19] Throughout the thesis I use "tax liability" and "tax debt" meaning all liability imposed under the taxing statute, including interest and penalties.

holds true even in contexts where contractual bargaining processes might have been expected, and where the process looks superficially like a contractual bargaining process. The result is that American taxpayers have access to mode of participation in the tax system that is not available to Canadian taxpayers.

In the fourth chapter I add some context to the discussion of the collection and compromise of tax debts. I examine the various collection powers that are available to the Internal Revenue Service and the Canada Revenue Agency, and the positions of the tax authorities in bankruptcy proceedings. Two related conclusions come out of this exploration. The first is that the choice against building a compromise mechanism into the Canadian tax system can not be convincingly explained by its strong position as a creditor. While the CRA does have strong powers to allow it to collect its debts prior to the debtor's insolvency, the IRS has comparable powers, and so the difference between the two regimes can not be explained so easily. Moreover, the CRA is not given a privileged position in bankruptcy proceedings, and, is arguably in a worse position than its American counterpart.

Having rejected one potential description of the difference between the two systems, I argue that the data suggest another description. In Canada, tax debts are forgiven, but the decision making processes for that forgiveness are located outside of the tax system. In the United States, the decision making about forgiveness of tax debts is reserved for the tax system. Each of these broad statements, while requiring some added nuance, is informative.

In chapter 5, I argue that a case can be made on tax policy grounds for compromise in certain situations in the Canadian income tax system. I suggest that a

compromise mechanism could be designed guided by the traditional tax policy considerations: administrative practicality, equity, and neutrality. I make the argument drawing on that framework, and briefly sketch out the parameters that a compromise procedure might fall within in order to further our tax policy goals.

I suggest that it is relatively clear that giving the tax authority the power to compromise can improve the administrative practicality of the system. More controversially, I argue that there are several ways in which we might expect a compromise program to improve the equity of the tax system. I acknowledge that there may be concerns about the incentives that a compromise program would create, but suggest that such a program could be designed to mitigate these. I also briefly explore the possibility that we might think of a compromise program as a tax expenditure rather than as a part of the technical tax system.

To conclude, I acknowledge the perils of suggesting that a foreign legal mechanism like the American offer-in-compromise program could be easily transplanted into Canadian law. Indeed, one way to view the differences explored in this thesis is as a manifestation of different legal cultures around tax collection: the American culture of "rough justice" and the Canadian culture that expects more precision and rigour in the calculation of tax liability and in tax collection. However, both the American experience and the tax policy case I present here recommend that some compromise mechanism be implemented in the Canadian income tax system.

CHAPTER 2: SETTLEMENT AND COMPROMISE IN CANADIAN INCOME TAX LAW SINCE *CARTER*[20]

> "[W]e have regarded these [administrative] matters as of major concern if only because shortcomings in the tax organization can frustrate the best tax policy. In a sense tax policy can be no better than the instrument designed to carry it out."[21]

2.1 IMPORTANT, BUT OVERLOOKED

It is perhaps unsurprising that in the melee immediately following the release of the *Carter Report*, relatively little attention was paid to the Commission's recommendations for the administration of the income tax system.[22] After all, the Commission gave the tax administration a "fairly clean bill of health", and there were larger battles to be waged over the idea of a comprehensive tax base and the role of equity in a tax system.[23] In the decades since the Commission reported, some of the larger recommendations for administration have been implemented – the Tax Court of Canada has replaced the Tax Appeal Board, for example – and the debates over some of the Commission's more contentions proposals have continued.[24]

[20] A modified version of this chapter appears in the forthcoming: Brooks, *Fifty Years Later*, *supra* note 9. Reproduced by permission of Carswell, a division of Thomson Reuters Canada Limited.
[21] *Carter Report*, *supra* note 9, vol 5 at 95.
[22] However, see: Harold Buchwald, *Administration and the Carter Report* (Don Mills, Ont: CCH Canadian, 1967); John G McDonald, *Canadian Royal Commission on Taxation: Tax Administration* (Toronto: Butterworths, 1968).
[23] *Carter Report*, *supra* note 9, vol 5 at 95. Even when writing a largely positive review of the Commission's administrative recommendations, Harold Buchwald felt the need to voice his agreement with "those who have challenged the Commission's underlying thesis of an 'equitable' tax system" (Buchwald, *supra* note 22 at 7).
[24] The Commissioners recommended the establishment of the Tax Court of Canada: *Carter Report*, *supra* note 9, vol 5 at 166-67. Although the precise structure of the court recommended by the Royal Commission was not adopted, the Tax Court of Canada was created in 1983 by the *Tax Court of Canada Act*, RSC 1985, c T-2 [*TCC Act*]. For examples of ways in which the Royal Commission's work still influences debates around taxation in Canada, see: W Neil Brooks, ed, *The Quest for Tax Reform: The Royal Commission on Taxation Twenty Years Later* (Toronto: Carswell, 1988); Brooks, *Fifty Years Later*, *supra* note 9.

Meanwhile, proposals that the Commission made around the settlement and compromise of debts arising under the *Income Tax Act* have gone relatively unnoticed and have been rarely discussed in the scholarly literature.[25] Further, the development of Canadian tax law and practice in this area has, in some ways, moved in the opposite direction from that recommended by the *Carter Report*.

In this chapter, I present the Royal Commission's recommendations dealing with the settlement and compromise of tax debts. I also discuss how the law in this area has evolved in Canada since the *Carter Report*. In particular, my focus is on the discretionary power of the Minister of National Revenue (the "Minister") to cancel or waive interest and penalties assessed under the *Income Tax Act* and the requirement that tax disputes be settled only on a principled legal basis.[26] However, it is important to realize that the Minister's limited powers to settle and compromise tax debts exist in a context that allows other possible avenues for taxpayers to be relieved of tax debts, such as the bankruptcy system and remission orders under the *Financial Administration Act*.[27]

I argue that, at first blush, Canadian law in this area might be seen as honouring the Commission's commitment to equity in tax law. After all, refusing to compromise a tax assessment reinforces the idea that all taxpayers are being treated according to the rules. However, the fact that the *Carter Report* recommended broader powers for the Minister to compromise and settle should lead us to investigate further. In that sense, one of the main goals of this chapter is to justify the deeper exploration of compromise and forgiveness mechanisms in chapters 3, 4, and 5.

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[25] *ITA*, *supra* note 3.
[26] *Ibid*.
[27] *Financial Administration Act*, RSC 1985, c F-11 [*FAA*] s 23(2).

2.2 THE CARTER COMMISSION ON SETTLEMENT AND COMPROMISE

Although the Commission found the administration of Canada's tax system to be in relatively good shape, the *Carter Report* does identify several areas for improvement. In this section, I look at some aspects of the Commission's proposals for the settlement of tax disputes without litigation and their recommended importation of an "offer of compromise" procedure.[28] To some degree, these proposals were intended to respond to specific issues identified in the Commission's research, and so I discuss that context as well.

The Commission's proposals regarding the settlement of tax disputes responded to two related problems. On the one hand, the Commission felt that too many tax disputes were proceeding through the administrative appeal process and to litigation, and it sought to facilitate the settlement of these disputes at as early a stage as possible.[29] On the other hand, the Commission believed that public confidence in the tax system required "an open-handed and above-board dispensation of justice", and expressed their concern that the public's faith was being undermined by private and confidential settlements.[30]

To facilitate settlement of tax disputes, the Commission recommended a number of structural changes to the taxation division of the Department of National Revenue, including that it be replaced by a more independent Board of Revenue Commissioners. Most significantly for the discussion of settlement and compromise, the *Carter Report* suggests that the officers dealing with administrative appeals "should be given wide

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[28] The *Carter Report* uses the terminology "offer of compromise" while the American procedure is currently called "offer in compromise" (26 USC § 7122(c)). In this chapter, I use the two interchangeably to denote some administrative procedure by which Canada's tax collectors might be permitted to collect less than the amount assessed.
[29] *Carter Report*, *supra* note 9, vol 5 at 161-62.
[30] *Ibid*, vol 5 at 96.

powers of compromise and settlement similar to those given technical advisers in the Appellate Division in the United States."[31] In part, the Commission's intent was to reduce the bureaucratic obstacles to settlement by taking the head office out of the equation and empowering officers at the district level, subject to the approval of a regional supervisor.[32] However, it seems clear that the use of the word "compromise" was intentional, as one commentator noted at the time:

> This should go a long way towards effecting settlements where each party – both taxpayer and administration – believes himself correct and each has to get some concession from the other. Additionally, it will permit settlements in equitable areas where the transaction is probably within the confines of a legislative provision, which, no matter how willing the administration might be to waive, it legally can not, and, most important, it will legalize many settlements that have in fact been worked out in the guise of so-called "adjustments".[33]

In this chapter, I use the word "compromise" in this sense as well: to indicate a reduction in tax liability without a proper basis to change the underlying assessment of tax. The *Carter Report* recommended that the tax authorities be allowed to enter into compromise settlements with taxpayers; however, as I discuss below, they remain forbidden from doing so.

Another recommendation that the Royal Commission made about the partial forgiveness of tax debts deserves more attention than it has received. In a discussion of tax collection, the Commission recommended that Canada implement an "offer of compromise" procedure similar to that available to taxpayers in the United States.[34] Broadly speaking, the procedure would allow taxpayers to offer to settle their debts for

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[31] *Ibid* at 163.
[32] *Ibid*.
[33] Buchwald, *supra* note 22 at 28.
[34] *Carter Report*, *supra* note 9, vol 5 at 149.

less than the full amount owing without any challenge to the correctness of the assessment.[35] Under the system as it currently stands in the United States, tax liability may be compromised for any of three reasons: doubt as to the liability; doubt as to collectability; or to promote effective tax administration.[36] Under the terms of the compromise, the taxpayer waives his or her right to contest the amount of the tax debt and agrees to file tax returns and pay the required taxes for the next five years.[37]

The Royal Commission suggested that the revenue authorities should accept compromise offers from taxpayers who owe more than their net worth, but that the procedure should be unavailable to those who had knowingly understated their income.[38] The Commissioners also recommended that all compromises be made public to guard against abuse of the system.[39]

Given the Commission's overriding concern for equity in the tax system, it is striking that the *Carter Report* contains no consideration of the objections to compromise that might be raised on equitable grounds. After all, it would seem that the goals of assessing tax equitably on the comprehensive tax base would be frustrated if some taxpayers are not required to pay the tax assessed. By allowing the Minister to settle tax disputes on a compromise basis rather than defending the correctness of the assessment, we would risk privileging those taxpayers who fight with the revenue authority. Similarly, if we compromise to alleviate the hardships of taxpayers who owe more than

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[35] The details of the offer-in-compromise program are discussed in chapter 3 below. For other descriptions of the program, see: Richard C E Beck, "Is Compromise of a Tax Liability Itself Taxable - A Problem of Circularity in the Logic of Taxation" (1994) 14 Va Tax Rev 153 at 156–58; Oei, "Getting More", *supra* note 8 at 1077–81.
[36] 26 CFR § 301.7122-1(b).
[37] US, Internal Revenue Service, Form 656, "Offer in Compromise" (May 2012) [Form 656].
[38] *Carter Report*, *supra* note 9, vol 5 at 149.
[39] *Ibid*.

they can pay, we would risk subsidizing the overconsumption or risky behaviour of those taxpayers.

The Commission's recommendations for compromise might simply be considered pragmatic suggestions to aid the efficient collection of tax. Accepting a compromise settlement, rather than litigating on principle, will be a money saving option in cases where the amount of tax at issue is less than the considerable cost of going to court. Compromising in the collections context would allow the tax authorities to weigh the costs of applying the Minister's full panoply of collection procedures against the benefits of collecting part of the debt with less effort.[40]

However, to explain the Commission's proposals simply as trading administrative practicality for equity would be treating the subject too lightly. Given the degree to which concerns for equity and fairness permeate the *Carter Report*, it is worth considering whether a case for compromise can be made on those grounds. To begin, I examine the Canadian law in this area as it has developed since the release of the *Carter Report*, and argue that, while it appears at first blush to have been designed with fairness and equity in mind, there are significant practical difficulties that should lead us to reconsider the desirability of compromise.

2.3 A "Principled Basis" for Settling Disputes

While the recommendations of the *Carter Report* on compromise and forgiveness of tax liability have gone largely unconsidered in the academic literature, Canadian law and practice have taken steps in the other direction. At least since the 1970s, Canadian courts have been clear in sending the message that the Minister of National Revenue's

[40] In fact, the American experience with the offer-in-compromise procedure appears to show even greater benefits for revenue generation than contemplated here (Oei, "Getting More", *supra* note 8 at 1083–86).

power to administer the *Income Tax Act* includes very limited discretion to settle, compromise, or forgive tax debts. The Federal Court of Appeal's decision in *Galway* is usually understood as the best authority for the restrictions on the Minister's ability to settle disputes; however, as mentioned above, the understanding of the Minister's powers that crystallized in *Galway* goes back at least to the days of the Royal Commission.[41]

Frank Galway had been associated with a real estate brokerage, but described himself as a "business broker". That is, he acted for either the purchaser or the vendor in the purchase and sale of businesses as going concerns. In addition to being a broker, Mr. Galway operated businesses that he acquired in Canada and in the U.K.[42] Though a series of transactions in 1960 and 1961, he found himself richer by $200,500 worth of shares. The Minister characterized this receipt as remuneration for services rendered, arguing that Mr. Galway had acted as a broker in this series of transactions and been paid in shares for his work. In appealing his assessment, Mr. Galway described himself as an investor in the enterprise, rather than a broker, making his efforts in the enterprise equivalent to capital expenditures. He argued that the shares should be characterized as an untaxable gift or windfall that the transferor had been under no legal obligation to give him.[43]

Mr. Galway lost his appeals at the Tax Appeal Board and at the Federal Court, Trial Division.[44] He filed a further appeal before the parties agreed to a settlement of the

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[41] *Galway v Canada (MNR)*, [1974] 1 FC 593, 2 NR 317, 74 DTC 6247 [*Galway (FCA) 1*]; *Galway v Canada (MNR)*, [1974] 1 FC 600, 2 NR 324, 74 DTC 6355 [*Galway (FCA) 2*]; Buchwald, *supra* note 22 at 28.

[42] *Galway v Canada (MNR)* , 72 DTC 6493 [*Galway (FCTD)*] at 6494.

[43] *Ibid* at 6497–98. Logically, Mr. Galway's characterization leads to an argument that he received a capital gain (which also would have been untaxable in 1960-61), but "windfall or gift" is the language that appears in the reasons.

[44] Galway presented no evidence at the Tax Appeal Board. At the time, a trial *de novo* was available on appeal from the Tax Appeal Board to the Federal Court, Trial Division.

dispute. On the $200,500 of taxable income, Mr. Galway had been assessed $133,381.58 in tax and another $32,344.89 in interest. To settle the appeal, the Minister agreed to accept $100,000.

Faced with an application for a consent judgment on those terms, the Federal Court of Appeal balked. A panel consisting of Chief Justice Jackett and Justices Thurlow and Pratte expressed doubts about their authority to set aside the Trial Division's judgment and order a lump sum reassessment of $100,000 for taxes and interest, and asked the parties to make further submissions on the subject.[45]

Given this opportunity, the parties essentially agreed that the consent judgment could not be given on the terms proposed, and attempted to find another way to accomplish the same end.[46] The judges explained that the Minister is not empowered to implement a compromise, and the Court can not authorize it:

> 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.[47]

The parties were then invited to submit a revised application for consent judgment that reflected the proper application of the law to the facts.[48]

A similar case that was decided after *Galway,* but which relates to events that occurred before the decision in *Galway* was released, reinforced the principled basis

[45] *Galway (FCA) 1*, *supra* note 41.
[46] *Galway (FCA) 2*, *supra* note 41 at para 3.
[47] *Ibid* at para 7.
[48] *Ibid* at para 9.

doctrine. In *Cohen*, the Federal Court of Appeal dealt with a taxpayer who claimed that he had agreed not to appeal his assessments for 1961-64 in exchange for the Minister's agreement to treat proceeds from the sale of certain pieces of land in 1965 and 1966 as capital gains. Writing for a unanimous panel of the court, Justice Pratte held that, if such an agreement had been made, it would be illegal and would not bind the Minister.[49] While in *Galway* the compromise was obvious – there was no basis under the *Income Tax Act* to accept $100,000 in place of the assessed amount – *Cohen* confirms that it is not only obvious compromises that are forbidden. The Minister is also prevented from taking an assessing position that does not reflect her true understanding of the facts to implement a compromise.

Some, including Chief Justice Bowman and Professors Hogg, Magee, and Li, have found the Federal Court of Appeal's reasoning in *Galway* and *Cohen* difficult, if not impossible, to reconcile with the Supreme Court's decision in *Smerchanski*.[50] The tax authorities had agreed not to prosecute Mr. Smerchanski for tax evasion in exchange for a waiver of the his right to appeal. Chief Justice Laskin, writing for the majority, concluded that the waiver was enforceable and Mr. Smerchanski was barred from appealing.[51]

Professors Hogg, Magee, and Li argue that the effect of *Smerchanski* and *Cohen* together is that "the taxpayer is bound by a settlement agreement, but the Minister is not."[52] That is, the Minister and her delegates are constrained by their statutory powers

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[49] *Cohen v The Queen* (1980), 80 DTC 6250.
[50] *Smerchanski v MNR*, [1977] 2 SCR 23 [*Smerchanski*]; *Consoltex v The Queen* (1997), 69 AWCS (3d) 973, 97 DTC 724, [1997] 2 CTC 2846 at 731–32; Peter W Hogg, Joanne E Magee & Jinyan Li, *Principles of Canadian Income Tax Law* (Toronto: Carswell, 2010) at 573.
[51] *Smerchanski*, *supra* note 50. Laskin CJ wrote for the majority; the minority found it unnecessary to consider whether there was a valid agreement, as Mr. Smerchanski's conduct would render him disentitled to relief in any event.
[52] Hogg, Magee & Li, *supra* note 50 at 573.

and duties, while taxpayers are free to bind themselves in settlement agreements. They criticize the Federal Court of Appeal's position on practical and pragmatic grounds:

> The attitude of the Federal Court of Appeal in *Cohen* and *Galway* is far too rigid and doctrinaire. If the Minister were really unable to make compromise settlements, he or she would be denied an essential tool of enforcement. The Minister must husband the CRA's limited resources, and it is not realistic to require the Minister to insist on every last legal point, and to litigate every dispute to the bitter end. Most disputes about tax are simply disputes about money which are inherently capable of resolution by compromise. Presumably, the Minister would agree to a compromise settlement only on the basis that it offered a better net recovery than would probably be achieved by continuance of the litigation. It seems foolish to require the Minister to incur the unnecessary costs of avoidable litigation in the name of an abstract statutory duty to apply the law. It seems obvious that the Act should be amended to give the Minister express authority to settle cases.[53]

Later court decisions have held that the Minister may be bound by settlement agreements, where those agreements can be said to constitute an application of the law to the facts. While a compromise settlement without a basis in law would be *ultra vires*, the Minister might be convinced in settlement discussions that her initial view of the facts or the law was incorrect. Settlement is possible where a basis in the law – often referred to as a "principled basis" – exists to support it.[54] Judges of the Tax Court have taken the view that settlement agreements can be enforced against the Crown under these conditions, and, further, have suggested that it might not be their role to look closely at the propriety of these agreements.[55]

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[53] *Ibid* at 574 [footnotes omitted].
[54] *1390758 Ontario Corp v The Queen*, 2010 TCC 572, 2010 DTC 1385.
[55] *Ibid* at para 35; *Huppe v The Queen*, 2010 TCC 644, [2011] 2 CTC 2416, 2011 DTC 1042 at paras 7, 13, 18; See also *Softsim Technologies Inc v The Queen*, 2012 TCC 181, 2012 DTC 1187 at para 84, which dealt with an application to enforce a settlement agreement against the taxpayers, but in which D'Auray J indicates that settlement agreements should generally be taken to be enforceable against both parties.

To see the practical effect of the principled basis doctrine, we can consider the case of *CIBC World Markets*, which involved a dispute over the amount of input tax credits the appellant company could claim under Canada's *Excise Tax Act*.[56] Prior to litigation in the Tax Court, CIBC World Markets offered, in writing, to accept a reassessment allowing 90% of the input tax credits that it had originally claimed.[57] The offer apparently had no expiry date, and was on the table throughout the litigation.[58] The appellant lost at the Tax Court, but won on appeal to the Federal Court of Appeal, and, as a result, was allowed all of the input tax credits it had originally claimed.[59]

Under both the Tax Court Rules and the Federal Court Rules, an offer to settle can be considered in making a cost award.[60] Accordingly, CIBC World Markets argued that it had offered to settle on more favourable terms than the Crown eventually received from the Court, and so a higher than normal cost award was appropriate. The Federal Court of Appeal, however, accepted the Crown's argument that the Minister was not at liberty to accept the offer because the issue in the case was a binary, all-or-nothing, question of statutory interpretation. The Minister can not settle "solely on the basis of compromise, rather than following the facts and the law as the Minister views them or might

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[56] *CIBC World Markets Inc v Canada*, 2012 FCA 3, 426 NR 182 [*CIBC World Markets (FCA) 2*]; *Excise Tax Act*, RSC 1985 c E-15. Although the case implicates Canada's goods and services tax and not income tax, the same "principled basis" doctrine applies.
[57] *CIBC World Markets (FCA) 2*, *supra* note 56 at para 2.
[58] *Ibid* at para 3.
[59] *CIBC World Markets v The Queen*, 2010 TCC 460, [2010] GSTC 134, 2010 GTC 94 [*CIBC World Markets (TCC)*]; *CIBC World Markets v Canada*, 2011 FCA 270, 423 NR 163 [*CIBC World Markets (FCA) 1*].
[60] *Tax Court of Canada Rules (General Procedure)*, SOR/90-688a, ss 147(1), 147(3)(d) (see also: Practice Note 17 & Practice Note 18); *Federal Court Rules*, SOR/98-106, ss 400(1), 400(3)(e). For further discussion of the role of settlement offers in cost awards, see: *Donato v The Queen*, 2010 TCC 1049, 2010 DTC 1049.

reasonably defend them", and so there was no middle ground settlement available to the parties, only complete vindication for one or the other.[61]

It is not entirely clear how often the principled basis doctrine represents an insurmountable barrier to settlement rather than an inconvenience in settlement negotiations. While *Galway* and *CIBC World Markets* are examples of disputes that could not be resolved on a principled basis, at least some of the tax bar seems to view the principled basis doctrine as a test of inventiveness more than a real bar to settlement. Tax lawyers are challenged to present some reasonably defensible version of the facts and law that will allow the parties to find a middle ground, and, while there may be significant challenges in doing so, some suggest that it is almost always possible.[62]

Even in considering cases such as *Galway* and *CIBC World Markets*, which might be viewed as binary, all-or-nothing disputes that are not amenable to settlement on a principled basis, we should bear in mind that taxpayers and their representatives have some leeway to define the scope of the dispute. The issues on the table are those raised by the taxpayer who goes through the administrative appeal process and then drafts the Notice of Appeal. In *Galway*, for example, the evidence was fairly clear in establishing

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[61] *CIBC World Markets (FCA) 2*, *supra* note 56 at para 25; However, where the only options are complete vindication for one or the other, the Crown must give serious consideration to the strength of its position and concede the appeal or risk a cost award in excess of the tariff. See: *Blackburn Radio Inc v The Queen*, 2013 TCC 98.

[62] "Grounding a settlement in principle often requires a certain amount of strategizing, although some would suggest that if litigants are keen on settling the case, it is always possible to find a principled basis." (Pooja Samtani & Justin Kutyan, "Special Report: Tax Litigation Demystified" [2011] 59:3 Can Tax J 527 at 534); however, the search for a principled basis "can sometimes test counsel's creative ingenuity to the limit" (Craig C Sturrock & Kim Hansen, "Resolving Disputes with Revenue Canada" in *1991 British Columbia Tax Conference* [Toronto: Canadian Tax Foundation, 1991] 1:1 at 1:27); CRA officers may have considerable freedom to agree as to the facts, but still be hesitant to depart from CRA's prior interpretation of the law (Edwin G Kroft, "Settlement Strategies in Tax Disputes" in *2001 Prairie Provinces Tax Conference* [Toronto: Canadian Tax Foundation, 2001] 5:1 at 5:25); on the same theme, see: William Innes, "The Art of the Deal, Part 3: The Litigation Process" (1994) 46 Can Tax Found 32:1 at 32:17.

value of the shares that the appellant received.[63] However, had Mr. Galway been in a position to put the value of the shares at issue, or to put some other aspect of his tax assessment at issue, he might have had more flexibility in a give-and-take negotiation that still needed to respect the requirement for a principled legal basis.[64]

Some, including the Federal Court of Appeal in *Galway*, have suggested that although the Minister of National Revenue can not compromise to settle a dispute, the Attorney General might be empowered to do so.[65] This view is based on subsection 5(d) of the *Department of Justice Act*, which gives the Attorney General "regulation and conduct of all litigation for or against the Crown or any department", which might be taken to include the power to decide that compromise is appropriate.[66]

However, the Federal Court of Appeal later backed away from the view that the Attorney General might properly agree to a settlement that was not supported by the application of the law to the facts, and the more prevalent view is that the Attorney General either can not or should not compromise an assessment to settle a tax dispute.[67] In practice, it seems that tax litigators from the Department of Justice recognize that subsection 5(d) of the *Department of Justice Act* gives them ultimate control over the litigation, but take care to include the position of the Canada Revenue Agency in their decision making and will rarely take a course of action that is at odds with the CRA's

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[63] *Galway (FCTD)*, *supra* note 42 at 6497.
[64] For an example of a professionally advised taxpayer adopting a filing position with an eye towards conceding some issues in a principled-based settlement should the position be challenged, see: *Envision Credit Union v Canada*, 2010 TCC 576, 2010 DTC 1399, [2011] 2 CTC 2229 [*Envision Credit Union (TCC)*] at para 123. For a discussion of what disputes are amenable to settlement on a principled basis, see: David W Smith, "Reassessments, Waivers, Amended Returns, and Refunds" (1988) Corp Mgmt Tax Conf 8:1 at 8:14–15.
[65] *Galway (FCA) 1*, *supra* note 41 at para 12; Sandler & Campbell, *supra* note 9 at 770; Robert G Kreklewetz & John Bassindale, "Settlement of Tax Litigation" (2012) 20:2 Canadian Tax Highlights 5 at 5.
[66] *Department of Justice Act*, RSC 1985, c J-2, s 5(d).
[67] *The Clarkson Company Limited v The Queen*, [1979] 1 FC 630 at 631-32, n 3; Barbara A Burns & Ian S MacGregor, "Resolving Tax Disputes: A Justice Perspective" (1994) 46 Can Tax Found 33:1 at 33:9.

position.[68] In the normal course of practice, tax litigators at the Department of Justice see the CRA as the client from whom they take instructions.[69]

2.4 Fairness or Relief?

On December 17, 1991, in the middle of a 200-page bill containing myriad amendments to the *Income Tax Act* and several other acts, the set of provisions that was then referred to as the "fairness package" came into force.[70] The fairness package gave the Minister of National Revenue discretion to do the following: reassess in the taxpayer's favour beyond the three-year limitation period; allow elections to be made, amended, or revoked beyond the deadline; and, waive or cancel interest and penalties.[71]

The first two parts of the fairness package essentially give the Minister discretion to grant a reprieve from the inherent harshness of deadlines. Generally speaking, the *Income Tax Act* gives taxpayers three years from the end of the tax year to file an income tax return and request a tax refund, and three years from the date of the Minister's Notice of Assessment to ask for an adjustment.[72] However, subsection 152(4.2) allows individuals and testamentary trusts (but not corporations or *inter vivos* trusts) to request that their liability be redetermined within ten years of the end of the tax year, and gives the Minister discretion to grant that request; subsection 164(1.5) then allows the Minister to issue a tax refund.[73]

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[68] Burns & MacGregor, *supra* note 67 at 33:2; Donald George Hugh Bowman et al, "Tax Tales: A Conversation with Judges and Counsel" (2002) 54 Can Tax Found 33:1 at 33:19 (transcript of a panel discussion); Samtani & Kutyan, *supra* note 62 at 534.
[69] Robert McMechan, "Justice: Is the CRA its Client?" (2005) 13:11 Canadian Tax Highlights 1.
[70] When both English and French are included, Chapter 49 of the Statutes of Canada, 1991 runs to 397 pages.
[71] *ITA*, *supra* note 3, ss 220(3.1), 152(4.2), 164(1.5), 220(3.2).
[72] *Ibid* at 152(3.1), 152(4), 164(1), 207(2).
[73] *Ibid*, ss 152(4.2), 164(1.5); see also the definition of "individual" in s 248(1).

Similarly, subsection 220(3.2) gives the Minister discretion to allow a taxpayer to make, revoke, or amend certain elections after the normal deadline to do so, but within ten years of the end of the applicable tax year.[74] In essence, the Minister has the discretion to be generous about the timing of taxpayers' engagement with the system. This might include those who were unable to file on time, those who neglected to claim some benefit to which they were entitled, and those who wish that they had elected different tax treatment. However, these provisions do not allow the Minister to compromise or to forgive an amount that is owed. All that she can offer is the tax treatment to which the taxpayer would be entitled if not for the deadline.

On the other hand, when the Minister waives or cancels penalties or interest, she is forgiving an amount that the taxpayer is liable to pay under the *Income Tax Act*. Again, there is a ten year limitation period within which a taxpayer can request that interest or penalties be cancelled. While the *Income Tax Act* provides no direction on how the Minister should exercise this discretion, the CRA's view is that this relief may be appropriate for taxpayers who are unable to pay because of financial hardship and for those whose non-compliance was caused by either extraordinary circumstances or actions of the CRA.[75]

In thinking about relief from interest and penalties, we should consider the nature and purpose of interest and penalties. Interest is assessed due to taxpayers' failure to pay, to withhold, or to remit amounts on a timely basis as required by the *Income Tax Act*.[76] Penalties may be assessed due to taxpayers' failure to file returns as required, failure to

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[74] The eligible elections are prescribed in the *Income Tax Regulations*, CRC c 945, s 600.
[75] Canada Revenue Agency, Information Circular IC07-1, "Taxpayer Relief Provisions" (31 May 2007) [IC07-1] at paras 23–28.
[76] See e.g. *ITA*, *supra* note 3, ss 161(1), 227(8.3), 227(9.2).

make an instalment payment as required, failure to deduct or withhold amounts as required, or, failure to remit amounts that were deducted or withheld.[77] So, the provisions in the fairness package centre on forgiving non-compliance or late compliance with the *Income Tax Act*, without compromising the Minister's assessment. The core of the taxpayer's debt – the tax assessed under the *Act* – is not compromised or forgiven, except to the extent that the cancellation of interest allows inflation to decrease the value of the debt over time.

The fairness package was originally announced by the Minister of National Revenue in May 1991, and was trumpeted as a way to allow the revenue authority (then Revenue Canada, Taxation) to administer the tax system more fairly. The increases in the Minister's discretion were painted in a press release as allowing for "common sense" and making the tax system "simpler, easier and fairer" for Canadians.[78]

Politically, the use of the language of "fairness" is consistent with the line of attack that the Progressive Conservative party took while in opposition, before winning power in 1984. They established a task force that held public consultations on "Revenue Canada's abuse of Canadian taxpayers" and produced a report.[79] Still, there is something striking about the use of the term "fairness" in describing these discretionary provisions. It suggests that the discretion is needed to alleviate unfairness that is sometimes caused by normal operation of the *Income Tax Act*. The provisions in the fairness package

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[77] See e.g. *Ibid*, ss 162, 163, 163.1, 227(8), 227(9). The list here is not intended to be comprehensive, but to give an idea of when penalties may be assessed in Canada's income tax system.

[78] Revenue Canada, Taxation May 24, 1991 Press Release [available on Taxnet Pro]. Similarly, speaking at second reading in the House of Commons for the Minister of Finance, Hon John McDermid praised the fairness package for "increasing administration fairness" and improving the "flexibility and responsiveness" of the income tax system (House of Commons Debates, 34th Parl, 3nd Sess, vol 3 (7 October 1991) at 3367 (Hon John McDermid)).

[79] Tax Force on Revenue Canada, *Progressive Conservative Task Force on Revenue Canada: Report* (Toronto: CCH Canadian, 1984). "Now, Perrin, Deliver", Editorial, *The Citizen* (21 September 1984) A8.

specifically identify deadlines and penalties (but not the tax assessment itself) as possible sources of unfairness.

In 2007, the Canada Revenue Agency began phasing out the use of the term "fairness" when referring to these provisions.[80] Since then, CRA has called the former fairness package by its new name, "taxpayer relief". While the *Taxpayer Relief Procedures Manual*, produced for use by CRA officers, still calls the taxpayer relief provisions "a good example of the CRA's commitment to fairness", the Information Circular produced for the public does not use the word "fairness", except to say that the taxpayer relief provisions were formerly known as fairness provisions.[81] While the fairness package indicated a belief that the tax assessed under the *Income Tax Act* should be considered to be fair (and therefore not compromised), the move toward calling these discretionary provisions "relief" rather than "fairness" might be thought to signal a renewed belief in the fairness of the normal operation of the *Income Tax Act*, including its deadlines, penalties, and interest.

Finally, it should be noted that, while the Minister has no power to compromise, settle, or forgive an amount of tax assessed, she can recommend that the Governor in Council (that is, the Governor General acting on the advice of the federal cabinet) issue a remission order pursuant to subsection 23(2) of the *Financial Administration Act*.[82] This provision allows any tax or penalty, including interest, to be forgiven where "the

[80] IC07-1, *supra* note 75 at para 4. See also Canada Revenue Agency's Action Task Force on Small Business Issues, *Helping Small Businesses by Reducing the Compliance Burden: Report of the Canada Revenue Agency's Action Task Force on Small Business Issues*, (chair: William V Baker) online: Canada Revenue Agency <http://www.cra-arc.gc.ca/E/pub/xi/07-105/07-105-e.pdf> at 8. I can only speculate about the motivation behind the change in terminology; to my knowledge there has been no public explanation.
[81] Canada Revenue Agency, *Taxpayer Relief Procedures Manual*, online: <Taxnet Pro> [*Taxpayer Relief Manual*] at para 1; IC07-1, *supra* note 75 at para 4.
[82] *FAA*, *supra* note 27; For a more detailed look at remission orders than is presented here, see: H Arnold Sherman & Jeffery D Sherman, "Income Tax Remission Orders: The Tax Planner's Last Resort or the Ultimate Weapon?" (1986) 34 Can Tax J 801.

Governor in Council considers that the collection of the tax or the enforcement of the penalty is unreasonable or unjust or that it is otherwise in the public interest to remit the tax or penalty."[83] These remission orders are required to be made public, and the power is used fairly sparingly.[84] The *Public Accounts of Canada 2012* show that 13 remission orders were issued in the fiscal year ending on March 31st, 2012, forgiving tax, penalties, and interest of slightly more than $205,000.[85] Of those 13, seven involved the remission of income tax, and one involved GST.[86]

2.5 THE NEED TO RECONSIDER COMPROMISE

Canada's treatment of settlement and forgiveness seems designed to reflect a principled defence of equity and a statement of faith in the fairness of the income tax system. The core of a tax debt – the tax assessed itself – is only compromised under extraordinary circumstances with a remission order, in the context of bankruptcy proceedings where all debts may be compromised, or to the limited extent that a waiver or cancellation of interest allows its value to depreciate over time. The strictness of these rules provides some comfort that the income tax is being applied to all in an even-handed way.

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[83] *FAA*, *supra* note 27, s 23(2).

[84] *Ibid*, s 24(2); *Taxpayer Relief Manual*, *supra* note 81 at para 8.12, says "a remission order is a very rare and extraordinary measures that allows the government to provide full or partial relief from a tax or penalty."

[85] Receiver General of Canada, *Public Accounts of Canada 2012: Additional Information and Analyses*, vol III (Ottawa: Minister of Public Works and Government Services Canada, 2012) at 2.3-2.5. Another four remission orders with a value of slightly more than $210,000 are shown in the 2012 *Public Accounts* as having been made in March of 2011 (*ibid*). A further 14 remission orders were made in previous fiscal years, but impact the tax collected by the federal government on an ongoing basis. For example, the 2012 *Public Accounts* show $265,042 remitted in that year because of a remission order dated June 12, 2003, which grants a remission of federal income tax and GST to "Indians and Indian bands on the campus of the Saskatchewan Indian Federated College" *(ibid*).

[86] *Ibid.* The remaining five remission orders provided for the remission of penalties and interest in situations where the taxpayer relief provisions were not available because more than ten years had passed since the end of the relevant taxation year.

Where the tax administration has been willing to admit that unfairness exists in the tax system, and so provisions in the fairness package are needed, administrative measures like deadlines and penalties are to blame; the underlying tax assessment is still thought of as fair. Even where interest and penalties are forgiven, the administration prefers to label it relief that a taxpayer might need, rather than view the forgiveness as mitigating unfairness caused by the normal operation of the tax system.

Tax disputes may be settled extrajudicially, but only on a principled legal basis consistent with the application of the law to the facts as the Minister sees them. The Minister is not empowered to settle for "litigation risk", as is sometimes proposed, and so we need not confront the spectre of a tax discount for those who can afford to hire the best tax litigators.[87] Two tax litigators for the Department of Justice put it as follows:

> Not only does the minister have a positive duty to ensure collection of all tax properly due and owing, but in doing so he must treat all taxpayers equitably. A compromise settlement that results in an extralegal reduction of the liability of one taxpayer will not be consistent with the treatment accorded all other taxpayers who are called upon to pay their full assessed share.[88]

However, given that a different path was recommended in the *Carter Report*, a document animated by a fundamental concern for equity in the tax system, I suggest that the notions of compromise and forgiveness deserve further consideration. A number of different lines of analysis might be pursued in considering the role of compromise in Canadian income tax.

[87] See Sandler & Campbell, *supra* note 9.
[88] Burns & MacGregor, *supra* note 67 at 33:9.

2.5.1 AS AN EQUITY / ADMINISTRABILITY TRADE-OFF

It is fairly clear that a pragmatic argument can be made in favour of compromise.[89] Allowing the CRA to accept less than the full amount of the liability – either in the dispute resolution context or in the collection context – would provide the flexibility to spend less on litigation and collection procedures and to maximize the revenue collected. Given that pragmatic case, we might reconsider whether some system involving compromise might be able to succeed in alleviating our fears about the damage to equity that compromise entails.

The first path would be to accept the premise that compromise decreases the equity of the system to some degree. From that starting point, the question is whether a compromise system could be designed that would maximize the practical benefits for the tax administration while minimizing the damage to equity such that the trade-off would be acceptable. For example, compromises of very small amounts might save considerable litigation costs while introducing minimal inequity. Similarly, compromises for taxpayers who truly can not pay will likely cost little, while saving the costs associated with trying to collect those debts.

2.5.2 AS A COUNTERWEIGHT TO EXISTING INEQUITIES

On the other hand, the uncompromising stance of the current administrative rules might be shown to be less equitable in practice than we might hope. There is some comfort in the knowledge that settlements of tax disputes must be grounded in the *Income Tax Act*; however, it is difficult to know how many of these settlements are *de facto* compromises for which lawyers were able to find a principled basis. While the resulting

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[89] Indeed, that argument has been made. See: Hogg, Magee & Li, *supra* note 50 at 573–74; Sandler & Campbell, *supra* note 9.

settlement must be justifiable on a principled basis, tax litigators for the Department of Justice will sometimes frankly admit that so-called “litigation risk” does play a role in settlement discussions.[90]

Further, if our concern is the advantage of those with access to professional representation, it is unlikely that the principled basis requirement removes this advantage. On the contrary, taxpayers might be better able to represent themselves in a straightforward give-and-take negotiation than they are in a settlement discussion structured around the provisions of *Income Tax Act*. Professional advisors, on the other hand, will have the familiarity with the principled basis requirement and the *Income Tax Act* to enable them to act effectively. That is, the principled basis requirement might be argued to increase the value of professional advice and thereby increase the disparity between those who have access to good advisors and those who do not.

If we accept that our uncompromising stance creates, rather than prevents, inequities in some cases, then a good argument could be made for a compromise system that addresses those cases or moves to counterbalance those inequities. For example, we might imagine a system that allows compromises for low income taxpayers to balance the advantage that higher income taxpayers have in dealing with the administration.

Indeed, the wording of the *Financial Administration Act* recognizes that the collection of tax is unreasonable or unjust in some cases. While the Royal Commission did not mention the availability of remission orders in discussing its recommendation for an offer in compromise procedure, remission orders were a part of the *Financial*

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[90] “Can we or the Tax Court or a court that has to issue a judgment in accordance with the Act do something not in accordance with the Act? No. Is litigation risk taken into account? Of course it is.” (Robert Carvalho, Ed Kroft & Al Meghji, “Current Cases” (2010) 62 Can Tax Found 2:1 at 2:20 (transcript of a panel discussion)).

Administration Act when the *Carter Report* was written and we can safely assume that the Commissioners were aware of that. One way to look at the offer in compromise recommendation is as a more widely available, more structured, and perhaps more controlled version of the remission order. Having recognized that these cases of unfairness exist, we can then ask whether a procedure can be designed to identify and deal with them rather than relying on the discretion of the federal cabinet.

Scholars have argued for both the compromise settlement of tax disputes and the American offer in compromise procedure as good “second-best” solutions in the non-ideal worlds of tax litigation and tax collection.[91] More work needs to be done in thinking through the distributive effects of forbidding compromises and in the potential design of compromise procedures; however, it is at least conceivable that the inequities in the current system are great enough that we would improve the equity of the system by allowing compromises in appropriate cases.

2.5.3 As Part of a Larger Equitable System

Compromises might also be justified as parts of a larger equitable whole. In the American context, Shu-Yi Oei has discussed the offer in compromise procedure as part of the broader tax system and as part of the social safety net.[92] If we are willing to consider the possibility that there are some other unavoidable inequities in the tax system, compromise procedures might be designed to compensate. Thinking even more broadly, if the compromise of a tax debt saves a taxpayer from bankruptcy, financial ruin, and reliance on Canada’s social safety net, then we might think of a compromise procedure as part of that safety net.

[91] See Oei, “Getting More”, *supra* note 8 at 1093ff; Sandler & Campbell, *supra* note 9 at 784–86.
[92] Oei, “Getting More”, *supra* note 8 at 1086–93; Oei, “Social Insurance”, *supra* note 8.

Looking at the problem from this angle would require a consideration of the bigger picture: what is the social safety net and how does it function in theory and practice? How would the compromise of tax debts interact with the welfare system? With the bankruptcy system? Given these broader considerations, there may be a place for the compromise of tax debts to supplement the existing safety net, or as a more efficient way of accomplishing the same goals.

2.6 Exploring the Case for Compromise in the Canadian Tax System

It is unclear whether the offer-in-compromise procedure used in the United States would be suitable for Canada, or whether those who worry about the detrimental effects to equity and to confidence in the taxation system are correct. There are differences in the broader legal context that need to be considered. For example, differences between Canadian and American bankruptcy law or differences between the administrative structures of the Canada Revenue Agency and the Internal Revenue Service might make importing the offer in compromise procedure problematic.

Similarly, a longer and more detailed consideration might find that the constraints on the administration's power to compromise in settling tax disputes are an invaluable safeguard against abuse of power and inequity. What I suggest, however, is that we should look more closely at both the theory underlying Canada's principled and uncompromising stance and its practical effects, and that more work can be done to question whether alternatives like those recommended in the *Carter Report* might better suit our tax policy goals and our broader social goals.

In this thesis, I explore the issue from several angles. In chapter 3, I discuss administrative processes that each tax system uses in allowing or restraining the

settlement, compromise, or forgiveness of tax debts. In chapter 4, I add context to the discussion by looking at powers given to the tax authorities as creditors. In chapter 5, I return to some of the questions posed in this chapter, and look at the case for compromise in the Canadian tax system through a tax policy lens.

CHAPTER 3: ADMINISTRATIVE PROCESSES OF FORGIVENESS

3.1 FRAMEWORK FOR COMPARISON

In the second chapter, I explored the history of several administrative processes by which Canada allows the forgiveness of tax debts, with some focus on the Carter Commission's recommendation that a version of the offer-in-compromise procedure be imported from the United States. I argued that, while Canada's current stance seems designed to further equity in the administration of the tax system, these issues deserve to be examined in more detail.

In this chapter, my goal is largely descriptive. I begin by describing the offer-in-compromise program as it currently exists in the United States. The program originates in legislation that gives the United States Secretary of the Treasury discretion to compromise tax debts.[93] The way that the discretion is exercised – the purposes for which it is used, the mechanisms and guidelines that restrict its use, the way that taxpayers interact with the administration in seeking this compromise – are fleshed out in a variety of places. The regulations developed by the treasury department provide some guidance, as do the *Internal Revenue Manual*, and the prescribed forms for taxpayers.[94] Aside from these internal measures that guide the IRS's behaviour in the process, there is, in some cases, a judicial review process that acts as a check on the IRS's discretion.

Canada has nothing similar to the offer-in-compromise program, but does have other contexts in which discretion is given to the tax administrators to forgive all or part

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[93] IRC § 7122. The Secretary's powers are exercised by the IRS.
[94] 26 CFR § 301.7122; US, Internal Revenue Service, *Internal Revenue Manual*, online: <http://www.irs.gov/irm> [*IRM*]; US, Internal Revenue Service, *Form 656 Booklet: Offer in Compromise*, online: <http://www.irs.gov/pub/irs-pdf/f656b.pdf>.

of a debt arising under the *Income Tax Act*.[95] Moreover, areas in which the discretion to compromise a debt is withheld may also be fruitful subjects for comparison. To that end, I take the same descriptive approach to the forgiveness of penalties and interest under the taxpayer relief provisions in the *Income Tax Act* and to the principled basis requirement for the settlement of tax disputes.[96] I attempt to flesh out the details of these processes using a variety of resources, including the *Income Tax Act*, various publications of the Canada Revenue Agency, and the *Taxpayer Relief Procedures Manual*.[97] Not all of these sources are authoritative "law" in the sense that a court would find them to be binding on the taxpayer or the administration. I use them in the discussion here because, whether or not they are authoritative or persuasive in a court, they do lay out rules, guidelines, and procedures that we can reasonably expect will govern the relationship between the taxpayer and the administration in the normal course of events.

These processes operate in somewhat different contexts, and so a direct comparison among them is challenging. In the American tax system, there are procedures that more closely resemble the taxpayer relief provisions than the offer-in-compromise program does; the offer-in-compromise operates alongside, and not instead of, these provisions. Accordingly, my approach in the analysis here is to look at the similarities and the differences between the offer-in-compromise program and the Canadian processes I discuss with an eye toward explaining the extent to which the two jurisdictions attempt to accomplish similar goals with different methods and the extent to

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[95] *ITA*, *supra* note 3.
[96] *Ibid*, s 220(3.1).
[97] *ITA*, *supra* note 3; Canada Revenue Agency, Form RC4288, "Request for Taxpayer Relief" [Taxpayer Relief Form]; IC07-1, *supra* note 75; *Taxpayer Relief Manual*, *supra* note 81.

which the offer-in-compromise program reveals goals, processes, and methods of participation in the tax system that are absent in Canada.

I suggest that, while there are similarities in the both the goals and the processes that I examine, the offer-in-compromise program provides an example of a contractual method of ordering the relationship between the administration and the taxpayer that is absent in the Canadian system. Even in places where we might expect to find contractual ordering, and where the administration might have discretion to engage in some bargaining, the Canadian system shows a strong preference for adjudicative processes.

3.2 OFFER IN COMPROMISE

The explicit power to compromise has a long history in the United States. The *Internal Revenue Code* authorizes the IRS and the Department of Justice to make compromises in tax cases, and provides a duty to keep records of such compromises:

> (a) **Authorization**. The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.
>
> (b) **Record**. Whenever a compromise is made by the Secretary in any case, there shall be placed on file in the office of the Secretary the opinion of the General Counsel for the Department of the Treasury or his delegate, with his reasons therefor, with a statement of --
>
> (1) The amount of tax assessed,
> (2) The amount of interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed, and
> (3) The amount actually paid in accordance with the terms of the compromise.

> Notwithstanding the foregoing provisions of this subsection, no such opinion shall be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) is less than $50,000. However, such compromise shall be subject to continuing quality review by the Secretary.[98]

In various forms, this provision has been a part of the tax system in the United States since 1868.[99]

While the Code's language appears to grant wide discretion to make compromises (the Secretary or the Attorney General "may compromise any … case", subject only to the requirement to keep a legal opinion on record), the practice has long been to restrict the situations in which the IRS has authority to compromise. As early as 1879, the position of the Attorney General of the United States was that the power to compromise could only be exercised where there was either doubt about the taxpayer's liability or doubt about the collectability of the debt.[100] The United States Supreme Court has held that this provision constitutes the exclusive means of compromising in tax cases, and so settlement agreements that fail to comply with the requirements of the provision are invalid and unenforceable.[101] In the regulations, the long standing grounds for compromise – doubt as to liability and doubt as to collectability – have been joined by the

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[98] IRC §§ 7122(a), 7122(b).

[99] HR 1284, 40th Cong, ch 186 (2d Sess 1868), 15 Stat 115, 166. For a more detailed review of the history of this provision, see I Jay Katz, "An Offer in Compromise You Can't Confuse: It Is Not the Opening Bid of a Delinquent Taxpayer to Play Let's Make a Tax Deal with the Internal Revenue Service" (2012) 81:7 Miss LJ 1673 [Katz, "Offer in Compromise"]; An earlier, less constrained version of the compromise power appeared in 1863. See Cong Globe, 37th Cong, 3rd Sess (1863), reprinted in JS Seidman, *Seidman's Legislative History of Federal Income Tax Laws 1938 - 1861* (New York: Prentice-Hall, 1938) at 1060.

[100] 16 Op Att'y Gen 248 (1879). Katz, "Offer in Compromise", *supra* note 99 at 1683–85, reports, leading up to the enactment of the Revenue Act of 1913, numerous opinions of the Attorney General held that valid claims against solvent taxpayers could never be compromised, and early income tax treasury regulations adopted this rule as well (see Rev Rul 20-1006, 2 CB 178 (1920)).

[101] *Botany Worsted Mills v United States*, 278 US 282 (1929).

promotion of effective tax administration.[102] Any of the grounds may be present to allow the administration to enter into a valid compromise.

In the IRS's view, the offer-in-compromise program has four objectives: (1) to effect collection of what can reasonably be collected at the earliest possible time and at the least cost to the government; (2) to achieve a resolution that is in the best interests of both the individual taxpayer and the government; (3) to provide the taxpayer with a fresh start toward future voluntary compliance with filing and payment requirements; (4) to collect revenue that may not be collected through any other means.[103] While these four goals focus on the bilateral relationship between the IRS and the particular taxpayer in question, the current National Taxpayer Advocate adds that the program may have beneficial effects for "tax morale".[104] That is to say that taxpayer compliance will be improved because the offer-in-compromise program increases the perception that "the IRS treats taxpayers with courtesy and respect and provides reasonable opportunities to resolve a tax liability when [taxpayers] lapse".[105]

3.2.1 DOUBT AS TO LIABILITY

Doubt as to liability stands apart from the other potential grounds of a compromise. It requires a reconsideration of the IRS's assessment of tax during the year in question, rather than a consideration of the taxpayer's current situation and ability to meet her obligations. In making an offer, the taxpayer uses a different form and is not

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[102] 26 CFR § 301.7122-1(b).
[103] *IRM*, *supra* note 94, § 5.8.1.1.4.
[104] Nina E Olson, "Minding the Gap: A Ten-Step Program for Better Tax Compliance" (2009) 20 Stan L & Pol'y Rev 7 [Olson, "Minding the Gap"] at 26.
[105] *Ibid*.

required to disclose her financial situation, provide a deposit, or pay an application fee.[106] Doubt as to liability is less commonly used to ground compromises than doubt as to collectability.[107]

In the words of the regulations, doubt as to liability exists where there is a "genuine dispute as to the existence or amount of the correct tax liability under the law", and not in any case where the liability has already been established by a court decision.[108] Generally, a taxpayer uses doubt as to liability to ground a compromise offer where she was unable to contest the tax liability within the time allowed.[109] Form 656-L, which is used to make an offer based on doubt as to liability, explains that what is required is a written statement of the reasons why the taxpayer doubts the amount of liability together with evidence or documentation to allow the IRS to evaluate the claim.[110]

IRS officers are directed to treat an offer based on doubt as to liability as they would an audit reconsideration.[111] This includes considering the written submissions, documentation, and evidence provided by the taxpayer, and requesting additional documents if necessary. Unlike the other two types of offers, which are handled by the "collection function" within the IRS, offers based on doubt as to liability are handled by the "examination function".[112]

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[106] IRC § 7122(d)(3)(b)(ii); US, Internal Revenue Service, Form 656-L, "Offer in Compromise (Doubt as to Liability)" [Form 656-L].
[107] United States Government Accountability Office, GAO-06-525, "IRS Offers in Compromise: Performance Has Been Mixed; Better Management Information and Simplification Could Improve the Program" (April 2006) [GAO-06-525] at 1; Beck, *supra* note 35, citing: Michael I Saltzman, *IRS Practice and Procedure*, 2d ed (Boston: Warren, Gorham & Lamont, 1991); Kevan P McLaughlin, "Strategies for Compromising Tax Debts" (2011) 211:6 Journal of Accountancy 50.
[108] 26 CFR § 301.7122-1(b)(1); *Oyer v Commissioner*, TC Memo 2003-178, aff'd 97 Fed Appx 68 (8th Cir 2004).
[109] Oei, "Social Insurance", *supra* note 8, citing Saltzman, *supra* note 107 at ¶15.07[1][b][i].
[110] Form 656-L, *supra* note 106 at 2.
[111] *IRM*, *supra* note 94, § 4.18.2.4.
[112] *Ibid* at §§ 5.8.1.1.3-5.8.1.1.4.

There are three possible outcomes of the examination. The offer should be accepted if the IRS examiner agrees that the amount offered by the taxpayer is adequate considering the degree of doubt established.[113] To a Canadian audience, this is a striking possibility. We would not expect a CRA officer at any level to conclude that there is some unresolved or unresolvable doubt as to the liability of a particular taxpayer. Rather, the CRA's approach would be to apply the administration's interpretation of the law to the facts as the CRA understands them, and to rely on the process of objections and appeals to make any necessary correction.[114] As noted above, accepted offers on this basis are less common than those based on doubt as to collectability; however, there clearly is space in the *Internal Revenue Code*, the regulations, and the *Internal Revenue Manual* for the IRS to admit doubt regarding the correct tax treatment of a taxpayer.[115]

The other two possibilities will appear more familiar to Canadians. If the IRS examiner and the taxpayer agree on the correct amount of the liability (which is distinct from agreeing that there is doubt regarding the liability), then the offer-in-compromise should be withdrawn and an adjustment to the liability will be made.[116] If the taxpayer and the IRS are not able to reach an agreement, the offer is rejected. However, before an offer is rejected by the IRS, the examiner sends the file to be reviewed internally by an

[113] *Ibid*, §§ 4.18.2.2, 4.18.2.4, 4.18.2.6.
[114] This is effectively the course laid out for the CRA by the Federal Court of Appeal in *Galway (FCA) 2*, *supra* note 41.
[115] IRC § 7122(d)(3)(b); 26 CFR § 301.7122-1(b)(1); *IRM*, *supra* note 94, § 5.8.1.1.2. However, Policy Statement P-4-117, which applies in the context of considering an offer based on doubt as to liability, examiners are directed to "consider and weigh conflicting factual information, data, and opinions... [e]xamining agents are encouraged to exercise this authority to obtain the greatest possible number of agreements to tax determinations without sacrificing the quality or integrity of those determinations". See *Ibid*, § 1.2.13.1.34.
[116] *IRM*, *supra* note 94, § 4.18.2.7.

independent administrative reviewer.[117] When an offer is rejected, the taxpayer has 30 days to file an administrative appeal which will be heard by the IRS Office of Appeals.[118]

Generally speaking, there is no review or appeal of the decision of the Office of Appeals.[119] However, where the rejected offer was made as a suggested collection alternative at a collection due process hearing, the taxpayer may apply to the United States Tax Court for judicial review.[120] In most cases, the Tax Court is deferential to the decision of the IRS, reviewing only for an abuse of discretion.[121] However, where the taxpayer is able to properly put the underlying liability at issue, which may the case if the taxpayer had grounds to make an offer based on doubt as to liability, the court will conduct a *de novo* review.[122]

Regardless of whether a compromise based on doubt as to liability is reached, the taxpayer still has the opportunity to make another offer based on doubt as to collectability. This fact highlights the point that a doubt as to liability offer has nothing to do with what the taxpayer can afford to pay. To be accepted by the IRS, the amount offered should reflect either the taxpayer's position regarding the correct amount of liability or an appreciation of the genuine doubt as to the liability. The taxpayer's financial situation – her ability to pay either the full amount or the compromised amount – is not considered at this stage.

[117] IRC § 7122(e)(1).
[118] IRC § 7122(e)(2); 26 CFR § 301.7122-1(f)(5); *IRM*, *supra* note 94, § 4.18.2.8.
[119] *Ibid* at § 8.23.1.3.
[120] IRC § 6320(d)(1).
[121] *Sego v Commissioner*, 114 TC 604 (2000); *Goza v Commissioner*, 114 TC 176 (2000).
[122] Where a taxpayer had the opportunity to dispute the underlying tax liability, she will be precluded from challenging the liability by IRC § 6330(c)(2)(B). For examples of cases in which such a challenge was allowed as no notice of statutory deficiency had been received and no previous opportunity to dispute the liability had arisen, see: *Cotler v Commissioner*, TC Memo 2007-283; *Molina v Commissioner*, TC Memo 2004-258.

3.2.2 DOUBT AS TO COLLECTABILITY

The most common ground for accepted offers is doubt as to collectability.[123] In evaluating offers made on this basis, the *Internal Revenue Code* provides that an acceptable offer should leave the taxpayer with sufficient resources to provide for basic living expenses.[124] The *Code* directs the Secretary to publish national and local allowances, and to consider, based on the facts and circumstances of each individual case, whether those guidelines are applicable. Moreover, the IRS is directed to provide special treatment to low-income taxpayers and not to "reject an offer-in-compromise from a low-income taxpayer solely on the basis of the amount of the offer".[125]

According to the regulations, "Doubt as to collectability exists in any case where the taxpayer's assets and income are less than the full amount of the liability."[126] Like the *Internal Revenue Code*, the regulations also direct the IRS, when considering an offer based on doubt as to collectability, to take into account the taxpayer's ability to pay and to permit the taxpayer to retain funds to pay basic living expenses, considering the individual facts and circumstances of a taxpayer's case and national and local living expense standards.[127]

In making on offer based on doubt as to collectability, the taxpayer must make a full and detailed disclosure of her financial situation. The prescribed form requires the

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[123] GAO-06-525, *supra* note 107 at 1.
[124] IRC § 7122(d)(2).
[125] IRC § 7122(d)(3)(A). According to the IRS: "A low-income taxpayer is an individual whose income falls at or below poverty levels based on guidelines established by the U.S. Department of Health and Human Services (HHS). Taxpayers claiming the low-income exception must complete and submit the Income Certification for Offer in Compromise Application Fee worksheet, along with their Form 656 application package." See US, Internal Revenue Service, *Revamped Offer in Compromise Program Plays New Role in Collection Process*, FS-2006-22, July 2006, online: IRS <http://www.irs.gov/uac/Revamped-Offer-in-Compromise-Program-Plays-New-Role-in-Collection-Process>.
[126] 26 CFR § 301.7122-1(b)(2).
[127] 26 CFR § 301.7122-1(c)(2)(i); IRC § 7122(d)(2)(A). In fact, it seems that this was the practice even before it was explicitly required by the IRC, see Katz, "Offer in Compromise", *supra* note 99.

taxpayer to disclose information about all of the following: her employment (including self-employment) situation; personal assets owned, including bank accounts, life insurance policies, real estate, vehicles, other valuable items; household income and expenses; secured debts; and, historical information about bankruptcies, lawsuits, and transfers of assets for less than full value.[128] Further, the form asks the taxpayer to attach documentation in support of the information provided: recent paystubs, bank statements, mortgage statements, and so on.[129] Taxpayers that are corporations, partnerships, or limited liability companies have a different, but similarly demanding, disclosure to make.[130]

At the end of the form, the taxpayer calculates a "minimum offer amount" based on the equity in her assets, her income, and her expenses. This amount is somewhat less if the taxpayer proposes to pay the amount within five months, and somewhat more if the payment is to be spread over a longer period. This minimum offer amount is referred to elsewhere as the "reasonable collection potential", and, in general, the evaluation of an offer based on doubt as to collectability turns on it.[131]

According to the *Internal Revenue Manual*, the reasonable collection potential reflects the amount that the IRS would be able to collect, including through the use of administrative and judicial collection remedies.[132] The determination includes a projection of the taxpayer's future ability to pay, taking into account factors such as age, health, marital status, dependents, education, training, experience, and employment

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[128] US, Internal Revenue Service, Form 433-A (OIC), "Collection Information Statement for Wage Earners and Self-Employed Individuals" (May 2012) [Form 433-A (OIC)].
[129] *Ibid* at 7.
[130] US, Internal Revenue Service, Form 433-B (OIC), "Collection Information Statement for Businesses" (May 2012) [Form 433-B (OIC)].
[131] US, Internal Revenue Service, Tax Topic 204, "Offers in Compromise" (23 May 2013) [Tax Topic 204] online: <http://www.irs.gov/taxtopics/tc204.html>; *IRM*, *supra* note 94 at § 5.8.4.3.
[132] *IRM*, *supra* note 94, § 5.8.4.3.

status.[133] If the taxpayer offers an amount equal to or greater than the reasonable collection potential, the IRS generally accepts it.

It is worth pausing at this point to highlight the fact that the calculation of reasonable collection potential – and therefore the acceptability of the offer, in most cases – does not depend at all on the amount actually owed by the taxpayer.[134] Instead, it reflects a pragmatic appreciation of the amount that the IRS could expect to collect given the taxpayer's current circumstances.[135] While the IRS's decision to accept or reject the offer will normally turn on the reasonable collection potential, other factors come into play which may sway the decision one way or the other.

3.2.2.1 Public Policy Considerations

Public policy considerations may cause the IRS to refuse an otherwise acceptable offer. The *Internal Revenue Manual* emphasises that these cases should be extremely rare and are based on projected public reaction to the compromise. According to the *Manual*, the IRS will exercise discretion to refuse an offer on public policy grounds where "public reaction to the acceptance of the offer could be so negative as to diminish future voluntary compliance by the general public."[136] The standard is not met simply because acceptance would generate public interest, including critical public interest, nor is it met simply because a taxpayer was prosecuted, including prosecutions for tax violations.[137] However, the *Manual* gives three scenarios that may warrant rejection on these grounds:

> (1) The taxpayer has in the past, and continues to openly encourage others to refuse to comply with the tax laws.

[133] *Ibid* at §5.8.4.3.
[134] The obvious exception being that the compromise offer will usually be rejected where the IRS reasonably expects that it might be able to collect the full amount owed.
[135] It also engages with the tax policy idea of "ability to pay" in a way that is explored in Chapter 5.
[136] *IRM*, *supra* note 94, § 5.8.7.7.2.
[137] *Ibid* at §5.8.7.7.2.

(2) Indicators exist showing that the financial benefits of a criminal activity are concealed or the criminal activity is continuing.
(3) The taxpayer engaged in a pattern of conduct suggesting intentional dissipation of assets.[138]

Both the general rule that public reaction should be considered and the specific examples provide evidence for the argument that the goals of the offer-in-compromise program include more than the four goals reproduced from the *Internal Revenue Manual* above. Also included, as the National Taxpayer Advocate says, is the idea that offers-in-compromise should encourage, or at least not discourage, compliance with the tax system. While the four goals deal exclusively with the relationship between the IRS and the specific taxpayer in question, some consideration of the broader community does come into play.

3.2.2.2 Special Circumstances

Special circumstances may lead the IRS to accept an otherwise unacceptable offer based on doubt as to collectability. That is, the IRS may compromise a tax debt for less than the reasonable collection potential where there are compelling concerns of economic hardship, public policy, or equity. These offers are evaluated in the same way that offers based on the promotion of effective tax administration are evaluated; the criteria and procedures are discussed in more detail below.

3.2.2.3 Possibility of a Partial Payment Installment Agreement

The IRS will reject a compromise offer where it can reasonably expect to collect the full value of the debt, including cases where this can only be accomplished by virtue

[138] *Ibid* at 5.8.7.7.2.

of an installment agreement.[139] This is simply an extrapolation of the general rule that offers based on doubt as to collectability should only be accepted where doubt as to collectability actually exists.

However, in 2004, Congress amended the *Internal Revenue Code* to allow the IRS to enter into "partial payment installment agreements":

> The Secretary is authorized to enter into written agreements with any taxpayer under which such taxpayer is allowed to make payment on any tax in installment payments if the Secretary determines that such agreement **will facilitate full or partial collection** of such liability.[140]

The IRS may enter into an installment agreement even where the amount of the installments is so low that the full amount of the debt will not be collected before the statutory limitation period for collection expires. The advent of this alternative method for agreeing to collect a portion of the debt creates an interaction worth exploring between installment agreements and offers-in-compromise.

In evaluating a proposed offer-in-compromise, the IRS official is directed to consider whether the taxpayer has the ability to make installment payments, and, if so, how much of the debt could be collected before the statute of limitations bars the IRS from further collection action.[141] However, the IRS generally prefers the offer-in-compromise program, even in some cases where a partial payment installment agreement could collect more money. It cites "the benefit to the government of receiving payment at an earlier time, the compliance aspect of the [offer-in-compromise], [and] monitoring and default issues with a [partial payment installment agreement]" as considerations that

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[139] *Ibid* at § 5.8.4.3.
[140] IRC § 301.6159-1(a) [emphasis added].
[141] *IRM*, *supra* note 94, § 5.8.4.3.

generally favour an offer-in-compromise.[142] However, the IRS also considers "the difference between the potential amount received from a PPIA and the tax liability, the difference between the potential amount received from a PPIA and the offer amount, the taxpayers gross income and family size, and anticipated changes in the taxpayer's income or expenses."[143] Having considered all of these factors, the IRS may reject an offer-in-compromise on the basis that a partial payment installment agreement would yield a better outcome for the government.

3.2.3 Effective Tax Administration

In 1998, in the legislative history of the *Internal Revenue Service Restructuring and Reform Act of 1998*, Congress encouraged the IRS to develop offer-in-compromise procedures to take into account factors like "equity, hardship, and public policy where a compromise … would promote effective tax administration."[144] The treasury regulations developed in response explain that, where no other ground for compromise exists, the IRS may compromise a tax debt to promote effective tax administration.[145] These compromises are distinct from compromises on other grounds in that the tax liability is both valid and fully collectable. The IRS may compromise on this ground where full collection would cause economic hardship or where the taxpayer identifies "compelling public policy or equity considerations" and "demonstrate[s] circumstances that justify compromise even though a similarly situated taxpayer may have paid his liability in

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[142] *Ibid* at § 5.8.4.3.
[143] *Ibid* at § 5.8.4.3.
[144] *Internal Revenue Service Restructuring and Reform Act of 1998*, Pub L No 105-206, 112 Stat 685; US, *Conference Report to Accompany HR 2676* (HR Rep No 105-599) (Washington, DC: Us Government Printing Office, 1998) at 289. For more detail on the historical evolution of offer-in-compromise procedures, see Katz, "Offer in Compromise", *supra* note 99.
[145] 26 CFR § 301.7122-1(b)(3).

full."[146] The IRS is also called upon to consider the effect that either full collection or compromise would have on the public's perception of the tax system. The regulations acknowledge that in some cases, full collection would "undermine public confidence in the tax system".[147] On the other hand, the IRS is forbidden from compromising to promote effective tax administration where the compromise "would undermine compliance by taxpayers with the tax laws."[148]

As noted above, the factors discussed below which may ground an offer based on the promotion of effective tax administration are the same factors which the IRS will consider in evaluating an offer based on doubt as to collectability with special circumstances. The difference between a compromise based on doubt as to collectability with special circumstances and a compromise based on the promotion of effective tax administration is only whether doubt as to collectability exists. The consideration of "special circumstances" and the promotion of effective tax administration is the same.

3.2.3.1 Economic Hardship

The IRS may compromise to accept less than the full amount due where that amount could be collected, but the collection would result in economic hardship to the taxpayer. The treasury regulations define economic hardship with relation to the payment of basic living expenses:

> This [economic hardship] condition applies if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses. The determination of a reasonable amount for basic living expenses will be made by the director and will vary according to the unique circumstances of the

[146] 26 CFR § 301.7122-1(b)(3)(ii).
[147] *Ibid*.
[148] *Ibid*.

> individual taxpayer. Unique circumstances, however, do not include the maintenance of an affluent or luxurious standard of living.[149]

Three points worth highlighting in this definition. First, it opens this ground only to individuals. Corporations, partnerships, and limited liability companies have no living expenses, and so the IRS will not entertain a claim to economic hardship.[150] Second, the IRS is directed to look at the unique circumstances of the individual who seeks the compromise. Third, in considering these individual circumstances, only a basic standard of living is protected. The IRS will not accept compromises to allow the taxpayer to sustain an affluent lifestyle.

The regulations provide several examples of the unique factors that can support a finding of economic hardship. Economic hardship may be found where a taxpayer's entire income is expected to be exhausted in supporting dependants who have no other means of support.[151] Or, the taxpayer's assets, while sufficient to pay the tax debt, may be needed because of a long-term illness or disability.[152] Similarly, economic hardship may be found where the tax debt could only be satisfied by liquidating an asset that the taxpayer depends on to provide a basic standard of living.[153]

3.2.3.2 PUBLIC POLICY & EQUITY

The criteria for an acceptable offer based on public policy and equity grounds are somewhat less clear. The regulations state that these compromises are justified where the collection of the full debt would "undermine public confidence that the tax laws are being

[149] 26 CFR § 301.6343-1(b)(4).
[150] *IRM*, *supra* note 94, § 5.8.11.2.1.
[151] 26 CFR §§ 301.7122-1(c)(3)(i)(B), 301.7122-1(c)(3)(iii).
[152] 26 CFR §§ 301.7122-1(c)(3)(i)(A), 301.7122-1(c)(3)(iii).
[153] 26 CFR §§ 301.7122-1(c)(3)(i)(C), 301.7122-1(c)(3)(iii).

administered in a fair and equitable manner."[154] The taxpayer in such a case is expected to "demonstrate circumstances that justify compromise even though a similarly situated taxpayer may have paid his liability in full."[155]

The examples in the regulations offer some clarification about what it might mean to provide fairness and equity by treating similarly situated taxpayers differently. The first supposes that the taxpayer was hospitalized for a serious illness almost continuously for several years. Being incapacitated, the taxpayer was unable to manage his financial affairs. The example also assumes that the taxpayer's overall history of compliance with the tax system does not weigh against compromise. In the second, the hypothetical taxpayer was reasonably diligent, and, again, has a good history of compliance. However, due to bad advice received from the IRS, the taxpayer faces a steep tax bill.[156]

So, we might generally expect that in cases where a taxpayer was incapacitated and therefore unable to meet her objections under the *Internal Revenue Code* or where liability is attributable to some delay or error of the IRS, a compromise might be appropriate. Elsewhere, the *Internal Revenue Code* provides relief from penalties and interest in the same situations.[157] The *Internal Revenue Manual* adds that a compromise may be appropriate in the case of a not-for-profit, charitable, or exempt organization whose provision of an essential service to the community would be jeopardized by the

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[154] 26 CFR § 301.7122(b)(3)(ii).
[155] *Ibid*.
[156] 26 CFR §301.7122-1(c)(3)(iv).
[157] IRC § 6404 provides for the full abatement of penalties and interest resulting from erroneous written advice of the IRS; IRC § 6651(a) provides for the abatement of penalties with a showing of reasonable cause, which the *Internal Revenue Manual* states may include a taxpayer's illness: *IRM*, *supra* note 94, § 20.2.7.1; see also Katz, "Offer in Compromise", *supra* note 99 at 1730–36.

collection of the full debt, and in cases where the delinquency was caused by the criminal or fraudulent actions of a third party.[158]

3.2.4 ADMINISTRATIVE AND JUDICIAL REVIEW

Where the process results in the rejection of an offer, the taxpayer has 30 days to file an administrative appeal.[159] The IRS Office of Appeals promises an independent review in an "informal administrative forum".[160] There is generally no further right to appeal or review beyond the Office of Appeals.

However, where the offer-in-compromise was made as part of a collection due process hearing pursuant to IRC § 6330, the taxpayer may petition the Tax Court for review of the administrative appeal decision. The Tax Court will review the rejection of the taxpayer's offer for an abuse of discretion.[161] This is a reasonably high standard, sometimes rephrased as a review of "whether the [IRS's] determinations were arbitrary, capricious, or without sound basis in fact or law."[162] Because the standard of review is so high, it has been suggested that the availability of judicial review has made it more difficult for taxpayers to have their compromise offers accepted.[163] Moreover, even when the Tax Court finds an abuse of discretion in rejecting an offer, it does not conclude that the offer ought to have been accepted or make any finding about what an acceptable offer

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[158] *IRM*, *supra* note 94, § 5.8.11.2.2.1.
[159] *Ibid* at § 4.18.2.8. IRC § 7122(e)(2); 26 CFR § 301.7122-1(f)(5).
[160] US, Internal Revenue Service, "What Can Appeals Do for You?", online: <http://www.irs.gov/Individuals/What-Can-Appeals-Do-for-You%3F-1>.
[161] However, as noted above, there have been cases where, on rejection of an offer based on doubt as to liability, the Tax Court found that the underlying tax liability was properly at issue, and should be considered *de novo*.
[162] *Murphy v Commissioner*, aff'd 469 F (3d) 27 (1st Cir. 2006) , citing *Skrizowski v. Commissioner*, T.C. Memo. 2004-229; *Fowler v. Commissioner*, T.C. Memo. 2004-163; *Woodral v. Commissioner*, 112 T.C. 19, 23 (1999). See also *Sego v. Commissioner*, *supra* note 121.
[163] Katz, "Offer in Compromise", *supra* note 99 at 1737–39.

in the circumstances should have been.[164] While the IRS will be required to reconsider the offer, the appeals officer may find other reasons to reject it.[165]

3.2.5 Terms and Conditions

It is important to note that the taxpayer's debt will be compromised as a part of an accepted offer only if the taxpayer honours the terms and conditions of the offer. The required form requires that the taxpayer agree to the following:

> If I fail to meet any of the terms of this offer, the IRS may levy or sue me to collect any amount ranging from the unpaid balance of the offer to the original amount of the tax debt without further notice of any kind. The IRS will continue to add interest, as Section 6601 of the Internal Revenue Code requires, on the amount the IRS determines is due after default. The IRS will add interest from the date I default until I completely satisfy the amount owned.[166]

For offers based on doubt as to liability, relatively little is required of the taxpayer. The taxpayer is required to consent to the extension of various time limitations on the IRS while the offer is being considered, to waive any right to contest the tax debt once the offer is accepted, and she acknowledges that the IRS may file a lien on her property.[167]

For offers based on doubt as to collectability or the promotion of effective tax administration, much more is required of the taxpayer. The taxpayer is required to make a payment immediately to have the offer considered – 20% of the total offer value if the offer is to be paid in 5 for fewer monthly payments (called a "lump sum payment"), or the first monthly payment if the offer is to be paid over a longer period (called "periodic

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[164] *Ibid* at 1738–39.
[165] *Ibid* at 1739.
[166] Form 656, *supra* note 37 at 3. A similar clause (though worded differently) is found in the form for offers based on doubt as to liability: Form 656-L, *supra* note 106 at 2.
[167] Form 656-L, *supra* note 106 at 2–3.

payment"). In the case of periodic payment, the taxpayer is required to continue making the monthly payments while the offer is being considered.[168] If the offer is ultimately not accepted, the payments made will be kept by the IRS and applied to the taxpayer's debt.[169] The taxpayer also agrees to remain in compliance – filing returns and paying taxes – for a five year period after the offer is accepted.[170] As the offer form makes clear to the taxpayer, any material breach of the compliance term may result in the IRS pursuing collection of the entire debt.

3.3 TAXPAYER RELIEF (INTEREST AND PENALTIES)

As discussed briefly in Chapter 2, the *Income Tax Act* provides no discretion to allow the CRA to compromise tax assessed. However, many of the goals of the offer-in-compromise program are shared by the taxpayer relief provisions, under which the CRA is empowered to waive or cancel penalties or interest and offer other relief from various deadlines. The CRA explains its view of the taxpayer relief provisions as follows:

> The legislation gives the CRA the ability to administer the income tax system fairly and reasonably by helping taxpayers to resolve issues that arise through no fault of their own, and to allow for a common-sense approach in dealing with taxpayers who, because of personal misfortune or circumstances beyond their control, could not comply with a statutory requirement for income tax purposes.[171]

Moreover, the administrative mechanism that deals with the taxpayer relief provisions is somewhat similar to that of the offer-in-compromise program, and the criteria on which applications for relief are judged bear some resemblance to those on which the more rare compromise offers are judged. In the CRA's view, the circumstances

[168] IRC § 7122(c).
[169] Form 656, *supra* note 37 at 3.
[170] *Ibid*.
[171] IC07-1, *supra* note 75 at para 8.

that may justify relief from interest and penalties will generally fall under three broad categories (though relief may be granted in other situations as well): extraordinary circumstances, actions of the CRA, and inability to pay or financial hardship.[172]

3.3.1 EXTRAORDINARY CIRCUMSTANCES

Relief from interest and penalties may be granted where they result from extraordinary circumstances beyond the taxpayer's control.[173] The form used in requests for taxpayer relief offers the following as examples of extraordinary circumstances, in addition to the option of writing in a different extraordinary circumstance: "natural or man-made disaster"; "death/accident/serious illness/emotional or mental distress"; and, "civil disturbance".[174] What is imagined here is a flood, fire, death in the immediate family, or a major disruption in services that may prevent taxpayers from meeting their obligations under the *Income Tax Act*.[175] In these cases, Canada's position is not that any part of the tax debt should be compromised, but that a "common-sense approach" would not require taxpayers to pay penalties and interest.

The *Taxpayer Relief Procedures Manual* directs CRA officers to look fairly closely at these requests and to grant relief only to the extent that the taxpayer's default was actually caused by the extraordinary circumstances described. The taxpayer is asked to provide supporting documentation, such as police or fire reports, insurance statements, doctors' notes or death certificates, to explain how the event prevented compliance, and to describe what other means the taxpayer pursued in order to remain compliant.[176]

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[172] *Ibid* at paras 23–24.
[173] *Ibid* at para 25.
[174] Taxpayer Relief Form, *supra* note 97.
[175] IC07-1, *supra* note 75 at para 25; Taxpayer Relief Form, *supra* note 97.
[176] *Taxpayer Relief Manual*, *supra* note 81 at para 7.3.

3.3.2 ACTIONS OF THE CRA

Relief from interest and penalties may also be granted where the interest and penalties arise primarily because of errors or delays of CRA. These may include errors in processing a taxpayer's return, in publically available material, or in information given directly to a taxpayer. Similarly, delays in processing a return, completing an audit, or resolving an objection may justify the forgiveness of penalties and interest caused by those delays.[177]

The *Taxpayer Relief Procedures Manual* directs officers to be similarly thorough in evaluating claims made by taxpayers to ensure both a) that the taxpayer's default was a direct result of some delay or error of CRA, and b) to ensure that the delay or error was not attributable to incorrect information provided by the taxpayer or the taxpayer's own lateness.[178] However, CRA officials are also encouraged to proactively identify situations which may be appropriate for relief. For example, where the CRA takes an unduly long time completing an audit or resolving an objection, relief from penalties and interest may be offered without a request being made.[179]

3.3.3 INABILITY TO PAY / FINANCIAL HARDSHIP

The CRA makes clear in *IC-07* that it will rarely consider financial hardship as a ground for the forgiveness of penalties in the absence of the kind of extraordinary circumstances discussed above.[180] However, it does indicate its willingness to waive or cancel interest where it is able to confirm that a taxpayer is unable to pay. The examples that CRA provide to illustrate when this may be appropriate bear some resemblance to

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[177] IC07-1, *supra* note 75 at para 26.
[178] *Taxpayer Relief Manual*, *supra* note 81 at para 7.4.
[179] *Ibid* at para 7.4.1.
[180] IC07-1, *supra* note 75 at para 28.

situations considered under the offer-in-compromise program. Where a taxpayer's inability to pay has already led to collection being suspended or arranged via an extended payment arrangement, the CRA may waive interest.[181] Or, where payment of the accumulated interest would cause a "prolonged inability to provide basic necessities", cancelling all or part of the interest may be appropriate.[182]

Unlike the situation in the United States, in Canada it is usually only interest, not taxes or penalties, that the administration will consider forgiving. However, the CRA leaves open the possibility of an "exceptional situation" in which penalties may be cancelled in whole or in part. The example given is of a business whose survival is vital to the welfare of the community as a whole:

> For example, when a business is experiencing extreme financial difficulty, and enforcement of such penalties would jeopardize the continuity of its operations, the jobs of the employees, and the welfare of the community as a whole, consideration may be given to providing relief of the penalties.[183]

In support of a claim for financial hardship, the taxpayer is asked to make a "full financial disclosure", and, while that might be relatively clear, the CRA provides significantly less direction to taxpayers and transparency in its decision making than the IRS's Form 433-A and Form 433-B do. The CRA suggests the following for financial disclosure:

> Supporting documents could include financial statements (an income and expense statement, assets and liabilities statement), current mortgage statement and property assessment, loans and monthly bills, bank statements for

[181] *Ibid* at para 27.
[182] *Ibid*.
[183] *Ibid* at para 28.

> three months, current investment statements, copies of credit card statements, etc.[184]

Perhaps because of the rarity of this basis for relief, the CRA has not developed a more detailed form to guide taxpayers in making this financial disclosure or to explain how the information will be used in making a decision.

3.3.4 Administrative and Judicial Review

Although there is no statutory avenue to appeal a decision regarding taxpayer relief, the CRA does grant a second administrative review where a taxpayers request has been denied or only partially granted.[185] In requesting a second review, the taxpayer is asked to explain why she disagrees with the conclusions of the first decision and to provide any further evidence that might support her claim.[186] The second-level review will be conducted by a CRA official who was not involved in the first decision.[187]

If the request is rejected again, there is no further appeal (meaning that no other body will consider the facts and law *de novo*), however, the taxpayer may apply for judicial review in the Federal Court. Prior to 2005, the court would frequently apply the "patent unreasonableness" standard in reviewing the Minister's decisions under what were then called the fairness provisions.[188] However, a 2005 decision of the Federal Court of Appeal said clearly that the correct standard of review was reasonableness *simpliciter*, and a subsequent decision of the Supreme Court of Canada made the question

[184] Taxpayer Relief Form, *supra* note 97.
[185] IC07-1, *supra* note 75 at para 103.
[186] Taxpayer Relief Form, *supra* note 97.
[187] IC07-1, *supra* note 75 at paras 103–04; *Taxpayer Relief Manual*, *supra* note 81 at para 3.5.2.
[188] See, for example: *Beacock v Canada (Attorney General)*, 2005 FC 567, [2005] 2 CTC 351, 2005 DTC 5239; *Sharma v Canada (Customs and Revenue Agency)*, 2001 FCT 584, 206 FTR 40, [2001] 3 CTC 169, 2001 DTC 5360; *Cheng v Canada*, 2001 FCT 1114, 213 FTR 85, [2001] 4 CTC 190, 2001 DTC 5575; *Tywriwskyi v Canada (Attorney General)*, 2004 FC 542, 251 FTR 114, 2004 DTC 6431; *Heeg v Canada (Attorney General)*, 2003 FCT 337, [2003] 3 CTC 189, 2003 DTC 5265; *Brickenden v Canada (Customs and Revenue Agency)*, 2003 FC 929, 2003 DTC 5559.

moot by removing reasonableness *simpliciter* and patent unreasonableness from the lexicon of Canadian administrative law, replacing them with a standard of reasonableness.[189]

The reasonableness standard, contrasted with the correctness standard, requires that the reviewing court show deference to the administrative decision maker. It calls on courts to acknowledge that in some cases a range of conclusions or actions will be reasonable and to respect the fact that the legislature has placed the decision in the hands of the administrative body, which may have considerable expertise.[190] Fleshing the concept out in the context of the review of decisions to deny the waiver or cancellation of interest and penalties under subsection 220(3.1) of the *Income Tax Act*, the Federal Courts have shown that they will look for a degree of transparency, justification, and intelligibility that render the decision reasonable.[191] While the standard calls for some deference, taxpayers have been successful where the CRA's decision is based on factual or legal errors.[192] Courts can also be expected to intervene where the second-level review is undertaken by a decision-maker who was involved in the first review.[193] However, the reasonableness standard demands that the court recognize that a range of decisions are

[189] *Lanno v Canada (Customs and Revenue Agency)*, 2005 FCA 153, 334 NR 348, [2005] 2 CTC 327, 2005 DTC 5245; *Dunsmuir v New Brunswick*, 2008 SCC 9, [2008] 1 SCR 190 [*Dunsmuir*].
[190] *Dunsmuir*, *supra* note 189 at paras 47–50.
[191] *Telfer v Canada (Revenue Agency)*, 2009 FCA 23, 386 NR 212, 2009 DTC 5046, [2009] 4 CTC 123 at para 25.
[192] For cases in which the taxpayer was successful because the CRA's decision was based on factual errors or failed to consider relevant facts, see: *Slau Ltd v Canada (Revenue Agency)*, 2009 FCA 270, 394 NR 106, 2009 DTC 5167, [2010] 1 CTC 15 [*Slau*]; *Mackay v Canada (MNR)*, 2008 FC 1074, 334 FTR 269, 2008 DTC 6669, [2009] 1 CTC 174; For cases in which the taxpayer was successful on judicial review because the CRA's decision was based on a mistaken interpretation of the statute or a misapprehension of the administrative guidelines, see: *Nixon v Canada (MNR)*, 2008 FC 917, 330 FTR 315, 2008 DTC 6539, [2008] 5 CTC 263; *3500772 Canada Inc v Canada (MNR)*, 2008 FC 554, 328 FTR 188, 2008 DTC 6396, [2008] 4 CTC 1(Minister's decision overturned due both to factual errors and mistaken interpretation).
[193] *Edison v Canada*, 2001 FCT 734, 208 FTR 58, 2001 DTC 5428, [2001] 3 CTC 233 at para 38, finding a breach of the duty of fairness.

open to the administration, and so the court will usually refer the matter back to the Minister for reconsideration rather than substituting its judgement for the CRA's.[194]

3.4 Principled Basis Settlement of Disputes

Some of the history leading up to the crystallization of the principled basis doctrine for the settlement of tax litigation was reviewed in Chapter 2. Unlike the cases of the offer-in-compromise program in the United States and the application of the taxpayer relief provisions in Canada, there are no detailed published guidelines for tax administrators to follow in carrying out these negotiations. As a result, much of what we can learn about principled basis negotiation comes from anecdotes and from the relatively rare cases in which the parties needed a court to enforce the agreement reached. The principled basis doctrine offers a Canadian contrast for the offer-in-compromise program that exists in the United States, and which the *Carter Report* recommended be imported into Canada.

The *Income Tax Act* provides for extrajudicial settlement of appeals as follows:

> Notwithstanding section 152 [which provides the Minister's assessment powers], for the purpose of disposing of an appeal made under a provision of this Act, the Minister may at any time, with the consent in writing of the taxpayer, reassess tax, interest, penalties or other amounts payable under this Act by the taxpayer.[195]

The Minister's ability to settle is not limited to looking at the issues or the years under appeal, and it may include the reassessment of any amounts payable under the *Income*

[194] *Slau*, *supra* note 192 at paras 40–41.
[195] *ITA*, *supra* note 3, s 169(3).

Tax Act, including taxes, interest, and penalties.[196] However, as broad as the wording might seem, it does not empower the CRA to enter into compromise agreements.

In Chapter 2, I raised questions about the extent to which we should expect the spirit of the principled basis doctrine to be respected in practice. Where there are imaginative and motivated lawyers on both sides, we might expect to see compromise agreements "in the guise of so-called 'adjustments'".[197] Professionally advised taxpayers may prepare both their filing positions and their positions during the administrative objection and appeals process with an eye toward facilitating a principled basis settlement.[198] Moreover, oversight of the process only happens in public where one side seeks to repudiate the agreement and the other needs to have it enforced by a court, so it is difficult to judge the effectiveness of this restraint on the Minister's power to compromise.

These questions are worth exploring; however, it is probably safe to assume that letter of the rule are respected in nearly all cases and that the principle is respected in most cases. Most tax disputes are resolved without the assistance of tax lawyers. Even at the Tax Court level, many cases proceed with the taxpayer representing him- or herself and with a relatively inexperienced lawyer representing the Crown. These are less likely to be cases of savvy taxpayers who have taken positions with an eye toward conceding them or where a great deal of ingenuity has been brought to bear in striking a compromise that fits within the confines of the *Income Tax Act*.

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[196] Lisa M Macdonnell, "Settlement of Tax Disputes at the Appeals and Audit Stage" in *2012 Tax Dispute Resolution, Compliance, and Administration Report*, *supra* note 9, 6:1 at 6:2.
[197] Buchwald, *supra* note 22 at 28.
[198] *Envision Credit Union (TCC)*, *supra* note 64 at para 123.

3.5 Lessons from the Comparison

The above discussion reveals several similarities between the offer-in-compromise program and the Canadian laws that allow for settlement or forgiveness of tax debts. There are similar goals, similar concerns, and similar procedures. In this section, I begin by exploring ways in which aspects of the offer-in-compromise program are reflected in Canadian law. Following that, I draw from Lon Fuller's work in distinguishing different processes of ordering social relationships and suggest that the offer-in-compromise program allows for a contractual form of ordering.[199] I suggest that this type of engagement between the tax authority and the taxpayer is almost entirely absent in the Canadian system. The offer-in-compromise program allows for what might be thought of as consensual, horizontal, or reciprocal ordering between the taxpayer and the administration, and creates a relationship by which the taxpayer participates in the process through bargaining. In contrast, the Canadian system almost exclusively uses adjudicative processes, including in situations in which bargaining might be expected and those in which the Minister might have some discretion to bargain.

3.5.1 Echos of the Offer-in-Compromise Program in Canadian Law

The goals of the offer-in-compromise based on the promotion of effective tax administration are echoed in some of the discussions of the Canadian taxpayer relief provisions. The IRS's ability to accept offers to promote effective tax administration was added to allow it to accept offers where there is no doubt as to the underlying liability and no doubt that the debt could be collected in full, but where the forgiveness of part of the debt would promote effective tax administration because "either (1) collection of the

[199] Kenneth I Winston, ed, *The Principles of Social Order: Selected Essays of Lon L. Fuller* (Durham, NC: Duke University Press, 1981).

liability would create economic hardship, or (2) compelling public policy or equity considerations provide sufficient basis for a compromise."[200]

The taxpayer relief provisions were enacted in part to remedy "Revenue Canada's abuse of Canadian taxpayers".[201] They do this by giving "the CRA the ability to administer the income tax system fairly and reasonably".[202] In other words, the main thrust of the taxpayer relief provisions is to engender faith in the fairness of the tax administration.

Both jurisdictions grant this relief in cases of economic hardship. In the United States, economic hardship for the purposes of an offer to promote effective tax administration is defined based the ability to pay "reasonable basic living expenses".[203] In Canada, a taxpayer's accumulated interest charges may be forgiven where "payment of the accumulated interest would cause a prolonged inability to provide basic necessities".[204] Canada also may forgive interest and penalties in cases where the interest and penalties were caused by extraordinary circumstances or actions of the CRA.[205] The provisions are also described as "helping taxpayers resolve issues that arise through no fault of their own".[206] This language might also be a fair description of the many of the situations in which the IRS will accept an offer on public policy or equity grounds, such as liability caused by errors or delays of the IRS, criminal or fraudulent actions of a third party, or inability to comply because of serious illness.[207]

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[200] US, Department of the Treasury, Internal Revenue Service, *TD 9007 - Compromise of Tax Liabilities* at 3.
[201] Tax Force on Revenue Canada, *supra* note 79. "Now, Perrin, Deliver", *supra* note 79.
[202] IC07-1, *supra* note 75 at para 8.
[203] 26 CFR §§ 301.7122-1(b)(3)(i), 301.6343-1(b)(4).
[204] IC07-1, *supra* note 75 at para 27.
[205] *Ibid* at paras 25–26.
[206] *Ibid* at para 8.
[207] *IRM*, *supra* note 94, § 5.8.11.2.2.1.

3.5.2 ADJUDICATIVE VERSUS CONTRACTUAL ORDERING

One way to think about the difference between the Canadian and American approaches is in terms of the different modes of ordering the relationship between the taxpayer and the administration. While none of the three examples look purely like a contractual bargaining process or like a pure adjudicative process, looking at the distinctions between different forms of ordering may reveal something about the way that we see the relationship between taxpayers and the tax administration.

Lon Fuller explained the value of contractual bargaining as follows: "The special virtue of contract lies in its capacity to increase human satisfactions through an exchange, as where A has something B wants, B has something A wants, and an exchange will increase the satisfactions of both A and B".[208] Superficially, both the offer in compromise procedure and principled basis settlements seem to be designed to take advantage of this special virtue and to leave both the taxpayer and the tax administration better off. However, two important questions arise. First, do the constraints on the process seriously limit the value of contractual ordering in this case? Second, in this bargaining process, what exactly does the tax administration value, and what should it value?

3.5.2.1 CONSTRAINTS ON THE BARGAINING PROCESS

The offer-in-compromise program, by legislative mandate, uses a very structured process. The *Internal Revenue Code* directs the Secretary to prescribe standard guidelines for the evaluation of offers and to publish tables of what the IRS should consider to be basic living expenses in most cases.[209] As a result, the forms are fairly direct, and the

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[208] Lon L Fuller, "The Role of Contract in the Ordering Processes of Society Generally" in Winston, *supra* note 199, 169 at 184 [Fuller, "The Role of Contract"].
[209] IRC § 7122.

process is fairly predictable and transparent. The taxpayer proceeds by finding the values of her assets, looking at her income and living expenses, and arriving at an amount that she can pay the government while still being able to meet her basic needs and earn a living. While this structure does impose some limits on the freedom of taxpayers and the IRS to take full advantage of the negotiating process by constructing novel or innovative agreements, it is worth noting that the IRS does understand the government to be gaining when a compromise is reached.[210]

The principled basis doctrine makes the extrajudicial settlement of tax debts in Canada even more constrained. While the Minister does not have quite the same restrictions as the court would in resolving an appeal, she is equally bound to apply the law. The CRA can certainly be said to gain when the taxpayer withdraws an appeal as part of an extrajudicial settlement of the dispute – the government is spared the time and expense of litigation, and it may be able to collect the debt sooner. However, the CRA is forbidden from offering any compromise in order to achieve that gain, and so it is difficult to think of that process as a real negotiation.

While the details of the offer-in-compromise program do constrain bargaining, the contrast with a principled basis negotiation shows that it does retain many properties of a contractual negotiation. The IRS invites offers with certain characteristics, and when the offers come it evaluates them based on those criteria and its perception of its best interests. In contrast, the CRA's ability to settle depends on the taxpayer presenting evidence and argument to change the Agency's view of the situation. While the CRA stands to gain somewhat from settling the dispute without litigation, this is a secondary (or tertiary) concern.

[210] *IRM*, *supra* note 94, § 5.8.1.1.4.

This view of the constraints on the process is confirmed by the way in which the courts treat the two kinds of agreements. In the United States, an offer-in-compromise is simply a contract, and the normal federal laws of contract apply.[211] In Canada, a settlement agreement is only valid and enforceable if it represents the application of the *Income Tax Act* to the facts as the CRA understands them.

This conditional validity undermines the idea that a Canadian settlement should be thought of as a contract in the usual sense. As Fuller writes:

> If we asked one party to the contract, "Can you defend that contract?" he might answer, "Why, yes. It was good for me and it was good for him." If we then said, "But that is not what we meant. We meant, can you defend it on general grounds?" he might well reply that he did not know what we were talking about. Yet this is precisely the kind of question we normally direct toward the decision of a judge or arbitrator."[212]

In Canada, taxpayers can only enter into settlement agreements with the Crown with the expectation that they may be called upon to justify the agreement, not only on the basis that each side agreed to the settlement and that it improves the position of both sides, but on the basis that the settlement represents a legitimate application of the *Income Tax Act*. For the contract to be valid, it needs more than the consent of both parties free of duress, misrepresentation, or mistake, and so on. It requires that the settlement represent an outcome that the Tax Court, applying the *Income Tax Act*, might have reached if the appeal had gone ahead.

[211] *US v Lane*, 303 F (2d) 1 (5th Cir 1962); *Dutton v Commissioner of Internal Revenue*, 122 TC 133 (2004); *Trout v Commissioner of Internal Revenue*, 131 TC 239 (2008).
[212] Lon L Fuller, "The Forms and Limits of Adjudication" in Winston, *supra* note 199, 86 at 94–95 [Fuller, "Forms and Limits of Adjudication"].

3.5.2.2 THE TAX ADMINISTRATION'S INTERESTS

Looking at the question another way, the effect of the principled basis doctrine is that the Minister has no interest in compromise. Rather, the Minister's primary and overriding interest is in the correct application of the taxing statute. In those terms, not only does the Minister have nothing to give in a negotiation, but the Minister is not permitted to place much value on what she might gain.

To continue drawing from Fuller's categorization of social ordering devices, principled basis negotiation looks more like adjudication. That is, "a process of decision in which the affected party's participation consists of an opportunity to present proofs and reasoned arguments".[213] To further clarify the distinction between contractual ordering and adjudication, Fuller writes: "When I am entering a contract with another person I may present proofs and arguments to him, but there is generally no formal assurance that I will be given this opportunity or that he will listen to my arguments if I make them."[214] In a principled basis negotiation, the taxpayer is guaranteed not only the opportunity to present evidence and reasoned argument, but the promise is that Minister can be swayed by nothing else.

On the other hand, the statutory discretion to compromise leads to a situation where the IRS can bargain with an interest in collecting the most money, at the earliest possible time, at the least cost.[215] So, while the bargaining process is structured, and while the IRS agents evaluate the taxpayer's offer and respond to evidence and argument, the offer-in-compromise program creates something more like a real negotiation in that each side stands to gain something that it values.

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[213] *Ibid* at 93.
[214] *Ibid* at 94.
[215] *IRM*, *supra* note 94, § 5.8.1.1.4.

3.5.2.3 Use of the Discretionary Taxpayer Relief Provisions

If we were to find contractual ordering in Canada's tax system, the extrajudicial settlement of disputes is one place that we might expect to find it. However, in this arena, I suggest that the tax administration's commitment to adjudicative processes extends even beyond what is strictly required by the law. To illustrate this point, we can consider again the Minister's power to cancel or waive penalties and interest. The *Income Tax Act* provides the power as follows:

> 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.[216]

Aside from the 10 year limitation period, there is no statutory restriction on the Minister's power to forgive interest and penalties.

Accordingly, the legal rationale behind the principled basis doctrine – that the Minister has no statutory authority to compromise a tax assessment – does not hold to the extent that the assessment in question includes penalties or interest. While the Minister would, in any case, have the same public law duties as any other public decision maker, it is not at all clear that these would prevent the Minister from exercising the powers given to her in subsection 220(3.1) of the *Income Tax Act* as part of the extrajudicial settlement of a tax dispute.

[216] *ITA*, *supra* note 3, s 220(3.1). Here "waiver" refers to the forgiveness of interest and penalties not yet assessed, while "cancellation" refers to the forgiveness of penalties and interest already assessed.

However, the *Taxpayer Relief Procedures Manual* expressly forbids using the taxpayer relief provisions as part of a settlement: "The taxpayer relief provisions were not intended and should not be used as a way to negotiate settlement of a taxpayer's account. In all circumstances, taxpayer relief requests should be reviewed independently." So, even if the statute might allow the CRA to use the taxpayer relief provisions negotiating a settlement in either the collections context or the dispute resolution context – giving the CRA, effectively, one chip to bargain with – the Minister's position is that the taxpayer relief provisions were not intended for that purpose and should not be used that way.

3.5.2.4 Implications of Canada's Reliance on Adjudicative Processes

It is worth repeating that, on the whole, the contrast between Canada's system and that of the U.S. is not as stark as the labels "contractual" and "adjudicative" might suggest. In general, the U.S. tax system, like Canada's, relies heavily on adjudicative processes. The IRS makes determinations about tax liability, taxpayers contest those determinations in the Tax Court, and taxpayers participate in all of those processes by presenting evidence and making reasoned arguments. Moreover, the offer-in-compromise program has adjudicative elements.

However, its contractual elements do serve to highlight the Canadian system's reliance on adjudicative processes. In thinking about the implications of this heavy reliance on adjudication, Fuller's work is informative. While Fuller recognizes the difficulty in distinguishing between horizontal and vertical ordering processes, contractual ordering is one of the prototypical examples of horizontal ordering.[217]

[217] Fuller, "Role of Contract", *supra* note 208 at 172–73.

Adjudicative processes, on the other hand, are more indicative of imposition of the law from above.

Accordingly, it may be meaningful that the IRS attempts to turn non-compliant taxpayers into compliant ones by having them participate in a bargaining process. The different type of participation and different mode of relationship between the taxpayer and the administration does sometimes succeed in helping people become compliant taxpayers. Indeed, much of the criticism of the offer-in-compromise program in the United States argues that not enough compromises are accepted because the guidelines are too strict or because IRS officers are resistant to compromise.[218]

In Canada, however, the prevailing opinion seems to be that adjudicative processes safeguard the integrity of the system, and, that compliance with and faith in the tax system might be detrimentally affected if the tax authorities were permitted to compromise. Accordingly, taxpayers are left primarily with the presentation of evidence and argument as their way of interacting with the tax system.

3.6 Canada Eschews Contractual Ordering in the Tax System

In this Chapter, my goals were to describe in detail the administrative processes that implement the offer-in-compromise program, that control the exercise of the taxpayer relief provisions, and that govern the extrajudicial settlement of tax disputes. These processes do not form a complete picture of tax collection or dispute resolution in either jurisdiction, but they do help in illustrating some of the similarities and differences in approaches that the two jurisdictions take to the settlement, compromise, and forgiveness of debts arising within the tax system.

[218] Olson, “Minding the Gap”, *supra* note 104; Katz, “Offer in Compromise”, *supra* note 99.

I have argued that the Canadian system shows a strong preference for adjudicative processes while the American system allows for some contractual bargaining between the taxpayer and the tax authority. The American tax authority sees itself as having something valuable to gain through bargaining: the collection of more money, more quickly, at less cost. American policy makers appear to hope that the bargaining process can engage otherwise unengaged taxpayers and that the "fresh start" offered by the partial forgiveness of a tax debt can help non-compliant taxpayers become compliant. The Canadian system, on the other hand, shows a belief that adjudicative processes are vital to the integrity of the tax system or the top-down authority of tax law.

Both the detailed description of the procedures and the insights gleaned from the work of Lon Fuller on social ordering processes are revisited in Chapter 5. There, I consider the implications of the procedural choices made from the point of view of tax policy. Here the discussion focused on the processes themselves and the ways in which taxpayers might participate in the tax system. However, thinking about these processes and modes of ordering the relationship will also be useful in the consideration of how the ideas of settlement, compromise, and forgiveness interact with the tax policy notions of equity, neutrality, and administrability.

CHAPTER 4: TAX ADMINISTRATION AS CREDITOR

In the previous two chapters, I suggested that there are significant differences between the attitudes and approaches of Canada and the United States to the settlement, compromise, and forgiveness of tax debts. The American tax system allows the tax administration to compromise. It allows the taxpayer to participate in the tax system in different ways with the goal of repairing the relationship and bringing the non-compliant taxpayer into compliance with the requirements of the tax system. On the other hand, Canada's tax system – both in its positive law and in the way in which the tax administration exercises its discretion – views most compromise or forgiveness as inimical to the integrity of the tax system and the goal of equity between taxpayers.

The discussion thus far has also suggested an historical contrast between the two jurisdictions. The power to compromise has always existed in the American tax system. In Canada, there may have been some compromise in practice prior to the mid-1970s; however, the view that this practice was illegitimate was crystalized in the Federal Court of Appeal's decision in *Galway*.[219] By now it is trite law that the administration has no power to do anything other than apply the taxing statute to the facts as it understands them.

In the third chapter, I acknowledged that one significant problem in comparing these processes across the two jurisdictions is the differing contexts. There are social differences between Canada and the United States, situational differences between the dispute resolution context and the collections context, and differences in the legal

[219] *Galway (FCA) 2*, *supra* note 41.

contexts in which tax debts are collected in Canada and the United States. In this chapter, my goal is to flesh out some of the context regarding tax debts in the two jurisdictions.

The context that I examine in this chapter is the privileged position of the tax authority in debtor-creditor relations in the two jurisdictions. The way that the tax authority operates as a creditor is important because it forms the backdrop for any settlement, compromise, or forgiveness that takes place in the tax system. Understanding the tax authority's powers in debtor-creditor law might help in formulating an explanation of the incentives that the tax authority has to compromise and the motivation that policy makers have to build forgiveness into the tax system.

In this chapter, I look at the statutory collection powers given to the tax administration and the positions that the CRA and the IRS are afforded in bankruptcy proceedings. Both tax authorities have ample statutory powers to enable them to collect tax debts quickly and at low cost. The IRS arguably has a stronger overall position in bankruptcy proceedings, although Canadian law's strong protection for the Crown's interest in employees' source deductions is significant. However, any conclusion based on this comparison will necessarily be tentative. While looking at these two main features of the tax debt collection landscape should give a reasonable idea of the context, the full comparative picture of tax collection would include many other factors. Various differences in creditors' rights and remedies in the relevant provincial and state regimes can affect the collection of debts, as may the rules governing various corporate forms at either the national or sub-national levels, the marital property regimes in the two countries, and the less formalized – but perhaps no less powerful – controls that culture and politics place on aggressive tax collection.

Nevertheless, the consideration of statutory collection powers and rules applicable to tax claims in bankruptcy allows me to draw some conclusions. An explanation of the differences between the jurisdictions that relies on the incentives created by the tax authority's position as a creditor is unlikely to be persuasive. The CRA has a strong position as a creditor, but this can not completely explain the different attitudes towards compromise in the two jurisdictions because the IRS has a similarly strong position. Rather, consideration of the treatment of tax claims in the bankruptcy regimes suggests a different explanation: both jurisdictions choose to forgive tax debts in appropriate situations, and one key difference between them is where the decision is made. Canadian law and practice denies the tax authority the power to compromise, settle, or forgive, effectively delegating that task to the bankruptcy system. In American law, decision making around compromise is concentrated in the tax system and, to some extent, taken away from the bankruptcy system.

4.1 KEY STATUTORY COLLECTION POWERS

4.1.1 UNITED STATES: LIEN & LEVY

The Internal Revenue Code provides the IRS with a number of collection powers aimed at collecting tax debts quickly and efficiently. The federal tax lien is chief among these, providing a basis for a secured interest in a tax debtor's property. In addition to the lien, the IRS has an extrajudicial levy power and, in some cases, the ability to collect tax debts from third parties.

4.1.1.1 FEDERAL TAX LIEN

The centrepiece of the IRS's collection powers is the federal tax lien. The lien arises automatically and encumbers all of a tax debtor's property:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.[220]

In the words of the tenth circuit court of appeals, this provision "is broad and comprehensive and [includes] all of a taxpayer's property, except that specifically exempt to the payment of taxes."[221] The lien comes into existence when the assessment is made and remains in effect until the debt is paid, the limitation period for the collection of the debt expires, or the IRS releases the lien.[222]

While the lien exists immediately upon assessment, the Internal Revenue Code also provides for notice of the lien to be filed and to be given to the taxpayer directly.[223] Notice of the lien must be filed before the lien will be valid against a purchaser or the holder of a security interest, mechanic's lien, or judgment lien.[224] Filing of the notice happens according to the filing systems established by the states in which the property is situated, so a single lien may require filing in several different jurisdictions.[225] For these purposes, personal property, including intangible property, is deemed to be located at the taxpayer's residence, but notice for real property should be given in the state where the

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[220] IRC § 6321.

[221] *Citizens State Bank of Barstow, Texas v Vidal, Collector of Internal Revenue*, 114 F (2d) 380 at 382 (10th Cir 1940).

[222] IRC § 6322. Generally speaking, IRC § 6502 gives the IRS 10 years from the date of the assessment to collect the debt. In addition to full satisfaction or unenforceability of the debt, pursuant to IRC § 6325 and 26 CFR § 301.6325-1, the IRS may also release the lien after accepting a bond, or discharge certain pieces of property from the lien where the lien will still cover property valued at double the amount of the debt.

[223] IRC §§ 6323(f), 6320.

[224] IRC § 6323(a). "Purchaser" in this context is given a relatively narrow definition by IRC § 6323(h)(6), and includes only those who acquire an interested in property for "adequate and full consideration in money or money's worth".

[225] IRC § 6323(f).

property is located.[226] Accordingly, notice of a lien may need to be filed the state in which the taxpayer resides and each state in which the taxpayer owns real property in order to ensure that the government's interests are properly protected. Once notice of the lien has been filed, notice must also be given directly, in writing, to the tax debtor.[227] That notice informs the debtor of the amount of the debt, of her right to request a hearing, and of any available administrative appeals.[228]

Perhaps because of the complexities of the filing process, tax liens are not automatically filed. In the 2012 fiscal year, there were more than 8.1 million new delinquent accounts and an inventory of 11.4 million delinquent accounts at the end of the year.[229] In the same year, however, only slightly more than 700,000 notices of federal tax liens were filed.[230] Generally, the decision to file a notice hinges on whether the IRS believes that the taxpayer has sufficient assets to justify the cost of filing.[231]

Even where a lien has been filed, the Internal Revenue Code protects the interests of certain other creditors against the potential effects of the lien.[232] Some commercial financing arrangements and security interests will be protected where the transaction was agreed to in writing before the notice was filed.[233] Moreover, ten classes of interests are protected against the tax lien regardless of timing.[234] Among those who receive this protection are purchasers of securities and motor vehicles without actual notice of the tax

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[226] IRC § 6323(f)(2).
[227] IRC § 6320(a).
[228] IRC § 6320(a)(3).
[229] US, Internal Revenue Service, *2012 Data Book*, Publication 55B (Washington, DC: Internal Revenue Service, 2013) at 41.
[230] *Ibid*.
[231] Brief for Tax Law Professors (Jordan M Barry et al) as Amici Curia Supporting Vacatur (Anti-Injunction Act), *United States Department of Health and Human Services v Florida*, 132 S Ct 2566 (2012) (No 11-398) [Tax Professors' Brief in *HHS v Florida*] at 13.
[232] IRC §§ 6223(b) – 6323(d).
[233] IRC §§ 6323(c), 6323(d).
[234] IRC § 6223(b).

lien, attorneys with liens, holders of mechanic's liens with respect to real property, and public authorities holding liens to secure payment of real property tax, special assessment, or charges for utilities or public services.[235]

4.1.1.2 Levy

In addition to the federal tax lien, the IRS is given the power to seize and sell a tax debtor's assets. While both this "levy" power and the federal tax lien involve the use of the taxpayer's property to satisfy a tax debt, the levy does not depend on the lien, and the levy power is distinct from a foreclosure on the lien.[236] The IRS has the power to seize and sell a taxpayer's assets even if the lien has been relinquished.[237]

The statute allows the levy only 10 days after the IRS demands payment of the debt and 30 days after a notice of intent to levy and a notice of the right to a collection due process hearing are sent by registered mail, delivered in person, or left at the usual dwelling place or place of business of the tax debtor.[238] However, both the 10 day and 30 day notice periods can be waived where the IRS determines that the delay will jeopardize the collection of the tax.[239] The notice of intent to levy sets out the provisions and

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[235] IRC § 6223(b). It may be important to note that IRC § 6223(i)(1) deems an organization to have actual notice or knowledge when the exercise of due diligence would have brought the lien's existence to the attention of the individual conducting the transaction.

[236] IRC § 6334; Tax Professors' Brief in *HHS v Florida*, *supra* note 231 at 14; Wm D Elliott, "Leaning on the Lien: Standing on the Promises of IRS" (1988) 18:3 Cumb L Rev 581 [Elliott, "Leaning on the Lien"] at 623–24.

[237] Tax Professors' Brief in *HHS v Florida*, *supra* note 231 at 14.

[238] IRC §§ 6331(a), 6331(d), 6330. The three required notices – the notice of assessment and demand for payment, the notice of intent to levy, and the notice of a right to a collection due process hearing – may be issued at the same time (26 CFR §301.6331-2(a)(1)); however, the IRS's practice is generally not to issue the notice of intent to levy and the notice of right to a collection due process hearing until at least 10 days after the notice of assessment and demand for payment is issued (*IRM*, *supra* note 94, § 5.11.1.2.1).

[239] IRC §§ 6331(a), 6331(d)(3).

procedures related to the levy and sale of property, including available administrative appeals and alternatives that might prevent the levy.[240]

The IRS's levy power includes authority to seize any property or rights to property, and make repeated seizures until the debt is fully paid.[241] The levy may be made by serving a notice of levy on a third party to allow the IRS to seize directly a taxpayer's receivables, bank accounts, or wages; however, the levy generally extends only to property possessed and obligations which exist at the time of the levy.[242] So, a levy against a bank account is satisfied by the balance at the time of the levy, and a fresh levy will be required to seize future deposits.

Several exemptions are carved out of the general rule that any property owned by a tax debtor may be subject to an IRS levy. The exemptions are generally geared toward allowing the taxpayer to provide a basic standard of living for her family and enjoy the benefits of some government programs. The exempt property includes the following: necessary clothing and school books for the taxpayer and her family; limited quantities of fuel, provisions, furniture and personal effects in the taxpayer's household; a limited amount of books and tools necessary for the taxpayer's trade, business, or profession; a minimum exemption for salary and wages, plus an additional amount if the taxpayer is obliged to make support payments for minor children; unemployment benefits; some annuity and pension payments; workmen's compensation; and, some disability and public

[240] IRC § 6331(d)(4).
[241] IRC §§ 6331(a), 6331(c).
[242] 26 CFR § 301.6331-1(a)(1). The regulation clarifies that "[o]bligations exist when the liability of obligor is fixed and determinable although the right to receive the payment may be deferred until a later date." It is also worth noting that IRC § 7303(c) requires that the IRS give the taxpayer reasonable notice before contacting a third party to attempt to collect tax. Some exceptions apply, including cases in which notice might jeopardize collection.

assistance payments.[243] To reinforce the breadth of the levy power, however, the Code provides that only the specifically enumerated property is exempt from levy, notwithstanding any other law of the United States.[244]

4.1.1.3 Judicial Collection Remedies

When the IRS's administrative collection procedures are unable to satisfy the debt, the IRS may turn to the courts for help.[245] The district courts are given wide authority to "render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws."[246] In a review of federal tax collection procedures, two Alaska lawyers note that enforcement of the tax lien – that is, foreclosure on specific property – is the typical remedy.[247] However, more exotic measures authorized by courts have included a warrant to enter property without the consent of the owner and the right to be present at the opening of a safety deposit box.[248]

Perhaps more significantly, the federal tax lien protects the government's interests against other creditors who go to court to take collection action against the tax debtor. The Internal Revenue Code grants the United States the right to intervene in any civil action or suit to assert the tax lien, whether filed or not.[249] If the court denies the application to intervene, the tax lien will not be affected.[250] Where notice of a tax lien has

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[243] IRC § 6334(a).
[244] IRC § 6334(c).
[245] James K Wilkens & Thomas A Matthews, "A Survey of Federal Tax Collection Procedure: Rights and Remedies of Taxpayers and the Internal Revenue Service" (1986) 3 Alaska L Rev 269 at 283.
[246] IRC § 7402(a).
[247] IRC § 7403(a). Wilkens & Matthews, *supra* note 245 at 283 report that this is the most typical instance of judicial collection action.
[248] *Ibid*, citing *In re Gerwig*, 461 F Supp 449 (CD Cal 1978).
[249] IRC § 7424.
[250] *Ibid*.

been properly filed before the law suit commences, the plaintiff has a positive duty to enjoin the United States, or else the judgment in the suit will be subject to the lien.[251]

4.1.1.4 THIRD PARTY LIABILITY

The final set of powers to consider in the scope of statutory collection mechanisms provides the IRS the ability to collect tax liability from someone other than the primary debtor. Both Canada and the U.S. have incorporated into the taxing statute some provisions which hold those in control of a corporation responsible for some tax liabilities of the corporation. Similarly, fiduciaries or executors of an estate may be held liable for tax debts of the estate and those who receive property from a tax debtor may find that they receive some of debtor's liability at the same time.

4.1.1.4.1 The 100% Penalty for "Trust Fund" Taxes

The Internal Revenue Code imposes liability for withholding taxes, such as employment taxes withheld by an employer from the wages of its employees, on certain responsible persons by using a penalty equal to the full amount not withheld and paid over to the IRS.[252] For most purposes, this penalty is treated as a tax liability of the responsible person.[253] A reading of the provision shows that anyone may be liable where she is a "person required to collect, truthfully account for, and pay over any tax" and she "willfully fails" to do so or "willfully attempts in any manner to evade or defeat any such tax or the payment thereof".[254] The first prong of this test is sometimes rephrased as

[251] IRC § 7425(a)(1).
[252] IRC § 6672(a).
[253] IRC § 6671.
[254] IRC § 6672(a).

requiring that a "responsible person" be held accountable.[255] The statute contemplates that a responsible person may include an officer or employee of a corporation.[256]

A number of contextual factors may be relevant in determining whether an individual qualifies as a responsible person. Whether a person had significant control over the finances of the entity has been said to be "the most critical factor".[257] However, courts may also consider the duties outlined in corporate bylaws, an individual's authority to sign cheques, status as officer or director, and ability to hire and fire employees.[258] Perhaps the most sensible statement of the test is to look for the "power to control the decision-making process by which the employer corporation allocates funds to other creditors in preference to its withholding obligations."[259] Generally speaking, this rule can be expected to ensure that high-level managers are those held responsible; the IRS is likely to look first to assign liability to individuals with titles that indicate responsibility and those with signing authority.[260] However, the *Internal Revenue Manual*'s list of potential responsible persons also includes employees, shareholders, creditors, and payroll service providers.[261]

The second requirement – willfulness – requires little more than knowledge that federal taxes are not being withheld or paid over. The mere fact that one had a duty to remit the taxes to the IRS and was negligent "in failing to ascertain facts regarding a tax

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[255] See, for example *Hochstein v United States*, 900 F (2d) 543 at 548 (2d Cir 1990) [*Hochstein*].
[256] IRC § 6671(b).
[257] *Jones v United States*, 33 F (3d) 1137 (9th Cir 1994), citing *Hochstein*, *supra* note 255, repeated in *United States v Chapman*, 7 Fed Appx 804 (9th Cir 2001) [*Chapman*].
[258] *Jones v United States*, *supra* note 257; *Chapman*, *supra* note 257; *Gephart v United States*, 818 F (2d) 469 (6th Cir 1987).
[259] *Haffa v United States*, 516 F (2d) 931 (7th Cir 1975) at 936. This has been called the "touchstone" for determining who is a responsible person, see David M Walker, "The Section 6672 100% Penalty: How to Avoid Going Down with the Ship" (1993) 46:3 Tax Lawyer 801 at 804.
[260] Walker, *supra* note 259 at 804.
[261] *IRM*, *supra* note 94, § 5.7.3.3.1; As Walker, *supra* note 259 at 804–05 reports, case law has held accountable employees, officers, directors, shareholders, creditors, accountants, and attorneys, where they had sufficient control over the finances of the enterprise.

delinquency" is not sufficient.[262] However, "voluntary, conscious and intentional – as opposed to accidental" conduct, reckless disregard of the risk that taxes may not be paid, or failure to investigate or correct mismanagement may all qualify as willful failure.[263]

4.1.1.4.2 Fiduciaries and Transferees

The Internal Revenue Code allows the IRS to collect taxes from a transferee who has received something of value for less than full consideration from a tax debtor.[264] The term "transferee" in this context is defined to include "donee, heir, legatee, devisee, and distributee", and so may cover a variety of circumstances in which property changes hands.[265] In the IRS's view, it may apply to anyone who receives assets "for less than full, fair and adequate consideration".[266] Transferees can be held liable for the income taxes, estate taxes, or gift taxes owing by the transferor, up to the value of the property transferred.[267]

A fiduciary who allows distribution of the assets of a delinquent taxpayer may similarly be held responsible for unpaid taxes.[268] Claims of the U.S. government – including tax claims – are afforded statutory priority over other debts of an insolvent

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[262] *Bauer v United States*, 543 F (2d) 142 (7th Cir 1976) at 150; *Kalb v United States*, 505 F (2d) 506 (2d Cir 174), cert denied, 421 US 979 (1975) [*Kalb*] at 511.
[263] *Kalb*, *supra* note 262 at 511; *Monday v United States*, 421 F (2d) 1210 (5th Cir 1970), cert denied, 400 US 821 (1970) at 1215–17.
[264] IRC § 6901(a).
[265] IRC § 6901(h). An even more comprehensive definition is provided in the regulations at 26 CFR § 301.6901-1(b): "As used in this section, the term "transferee" includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in section 368, and all other classes of distributees. Such term also includes, with respect to the gift tax, a donee (without regard to the solvency of the donor) and, with respect to the estate tax, any person who, under section 6324(a)(2), is personally liable for any part of such tax."
[266] *IRM*, *supra* note 94, § 4.11.52.2; See also Wilkens & Matthews, *supra* note 245 at 292.
[267] IRC § 6901(a)(1); *IRM*, *supra* note 94, § 4.11.52.3.2.
[268] IRC § 6901(a)(1)(B); 31 USC § 3713(b).

estate or the estate of a deceased person.[269] Where a "representative of a person or estate" pays any other debts of that person or estate before paying a claim of the U.S., the representative becomes liable. To help in dealing with the uncertainty created by this potential personal liability, an executor can apply for a release from personal liability, and, upon payment of the amounts owed by the estate, will receive it.[270]

4.1.1.5 Collection Restrictions and Exceptions

Generally, the IRS can only take collection action once a tax has been "assessed". In the normal course of things, the process begins with a "notice of deficiency" which is mailed after the IRS determines that there is some tax liability that needs to be paid.[271] The "notice of deficiency" is sometimes called a "90-day letter", as it provides the taxpayer with 90 days in which she may file a petition to contest the liability in the Tax Court.[272] During these 90 days, the IRS is prevented from issuing an assessment, and therefore prevented from taking collection action.[273] If a timely petition to the Tax Court is filed, the IRS is prevented from determining any further deficiency for the same tax year and the bar to assessment of any amount included in the notice of deficiency lasts until the Tax Court renders its final decision.[274]

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[269] 31 USC § 3713(a). This section does not apply in bankruptcy cases, which are discussed later in this chapter.

[270] IRC § 6905(a); 26 CFR § 301.6905(a). The request must be made in writing, on the prescribed form, after the final tax return has been filed. The executor will then be notified of the amount owing by the estate within 9 months, and her personal liability will be discharged upon payment of that amount.

[271] IRC § 6212.

[272] IRC § 6213(a).

[273] IRC § 6213(a).

[274] IRC §§ 6212(c), 6213(a). Even where the taxpayer concedes part of the IRS's proposed adjustment, she need not pay any of the deficiency until her tax liability is finally determined by the Tax Court. See: K Martin Worthy, "The Tax Litigation Structure" (1971) 5:2 Ga L Rev 248; Werner F Wolfen & John R Cohan, "The United States as a Creditor for Taxes" (1957) 35 Taxes 684 at 685–87.

However, these restrictions on assessment and collection can lifted in appropriate cases.[275] In what is a called a "termination assessment" the IRS is directed to immediately determine the amount of tax liability for the current year or preceding year of a taxpayer who the IRS discovers "designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act (including in the case of a corporation distributing all or a part of its assets in liquidation or otherwise) tending to prejudice" the collection of income tax.[276] Similarly, where the IRS believes that delay will jeopardize the assessment or collection of a deficiency, it is empowered to assess immediately and demand payment.[277] Termination assessments and jeopardy assessments are subject to judicial review, but no prior judicial authorization is required.[278]

4.1.2 CANADA

The CRA's collection powers operate somewhat differently, but they also appear to be aimed at collecting the tax debt quickly and at low cost. In this section, I briefly review the powers that the *Income Tax Act* gives to the CRA, including registering a certificate in the Federal Court, garnishment of amounts owed to the tax debtor, and seizure and sale of the tax debtor's assets. In the next section, I suggest that these powers put the CRA in a comparable position to that of the IRS. While the details of the collection powers of the two tax authorities differ, both have a fairly robust set of statutory powers allowing them to collect tax debts quickly and efficiently. The similarities are such that a comparison of the collection powers given to the tax

[275] IRC §§ 6851, 6861.
[276] IRC § 6851.
[277] IRC § 6861.
[278] IRC § 7429(g).

authorities in the two jurisdictions does not offer a compelling explanation for the marked difference in attitudes towards compromise in the two jurisdictions.

4.1.2.1 Certificates and Memorials

Section 223 of the *Income Tax Act* provides a shortcut allowing the CRA access to all of the collection avenues normally available to judgment creditors. To accomplish this, the CRA first issues a certificate indicating the amount payable by the debtor.[279] This certificate can then be registered with the Federal Court and will have the same effect as a judgment of that court.[280] No notice to the tax debtor is required when the CRA registers a certificate; however, the CRA generally does inform the tax debtor by mail.[281] Among the remedies that the registration of the certificate opens up are the provincial systems for the registration of securities. The registered certificate (called a "memorial") may be used to create a secured interest – "a charge, lien or priority on, or a binding interest in property" – in the same way that a judgment of a superior court of the province can.[282] The Crown's encumbrance of the tax debtor's property is not given an unusually high priority – indeed, the *Income Tax Act* explicitly provides that the Crown's charge will be subordinate to those that were registered earlier – however, the speed with which the CRA is able to obtain its judgment may provide the Crown with an advantage over other creditors.

As a judgment of the Federal Court, the memorial opens up other possibilities to allow the CRA to collect the debt. The *Federal Court Rules* provide procedures allowing

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[279] *ITA*, *supra* note 3, s 223(2).
[280] *Ibid*, s 223(3). The text of the provision affords the court no discretion in the registration process: "On production to the Federal Court, a certificate ... shall be registered".
[281] Campbell, *Administration 2012*, *supra* note 9 at 341; Canada Revenue Agency, Information Circular IC98-1R4, "Tax Collection Policies" (1 May 2013) [IC98-1R4] at 3.
[282] *ITA*, *supra* note 3, s 223(5).

enforcement of a Federal Court order for the payment of money by, among others, a writ of seizure and sale and garnishment proceedings.[283] However, similar avenues for enforcement are provided directly by the *Income Tax Act*, without the need to register a certificate or proceed using the *Federal Court Rules*.

4.1.2.2 Garnishment & Set-off

Section 224 of the *Income Tax Act* gives the CRA the power to demand payment of a tax debt from a third party that would otherwise be paying that money to the tax debtor. The CRA can make this demand to any person who is, or will be within one year, liable to make a payment to the tax debtor. Amounts that the CRA demands under a garnishment order – also called a "requirement to pay" – must be paid to the government as they become due to the tax debtor.[284] In practical terms, this will give the CRA ready access to a taxpayer's bank accounts and to her wages or accounts payable as they become due. Unlike garnishment remedies that are sometimes available to other creditors, there are few procedural preconditions to garnishment under the *Income Tax Act*.[285] No judicial authorization is required (not even the minimal judicial authorization of a memorial issued pursuant to subsection 223(3) of the *Income Tax Act*), and no prior notice is required.[286]

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[283] *Federal Court Rules*, *supra* note 60 at 425.
[284] *ITA*, *supra* note 3, s 224(1).
[285] For the sake of comparison, consider *Rules of Civil Procedure*, RRO 1990, Reg 194, s 60.08, under which a creditor must first obtain a judgment and then file a form with the court registrar, together with a copy of a court order and an affidavit setting out all of the relevant particulars. On the other hand, *ITA*, *supra* note 3, s 224(1) requires only that the "requirement to pay" be issued in writing.
[286] There are, however, restrictions that the *ITA* imposes on collection generally. These and are discussed in section 4.1.2.5 below.

The CRA is also given the power, in some cases, to demand amounts that will be lent to the tax debtor in the next 90 days.[287] While this seems to be a broad power that might allow the tax administration to force a tax debtor to borrow to pay her tax debts, the interpretation usually given to the provision is slightly narrower. The CRA is said to have agreed that it does not have the ability to draw on an unused line of credit, for example.[288] However, it may intercept a loan that would otherwise be made to the debtor. So, while this power might not force the tax debtor to borrow to pay her tax debt, it could be used to prevent the tax debtor from borrowing for other purposes.

The CRA also has what is sometimes referred as an "enhanced requirement to pay" or "enhanced garnishment" power.[289] One enhancement provided by subsection 224(1.2) is the CRA's ability to intercept payments to the tax debtor's secured creditors whose right to receive those payments depends on the security.[290] So, in cases where the tax debtor has assigned some source of income to another creditor, and even where that assignment is protected by a security interest, the CRA can override it. However, not all tax debts are collectable in this fashion. Broadly speaking, the intention of the enhanced garnishment is to cover amounts that ought to have been withheld and remitted by the debtor, the most significant of these being employees' source deductions.

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[287] *ITA*, *supra* note 3, s 224(1.1)(a) applies where the CRA "has knowledge or suspects" that a financial institution will lend, or advance moneys to the tax debtor, or make a payment on the tax debtor's behalf. Paragraph 224(1.1)(b) gives the CRA similar powers to demand money from a person who it knows or suspects is employed by, engaged in providing services or property to, or is not at arm's length from the tax debtor and will lend or advance money to or on behalf of the tax debtor within 90 days.

[288] Stephen W Bowman, "Collections in the Insolvency Context" (1988) Corp Mgmt Tax Conf 12:1 at 12:7–12:9.

[289] *ITA*, *supra* note 3 at 224(1.2).

[290] *Ibid*, s 224(1.2). The enhanced garnishment provisions also provide a super-priority in bankruptcy proceedings, discussed below. For a brief history of the evolution of the enhanced garnishment power, see Jacob S Ziegel, "Section 224(1.2) of the Income Tax Act in the Supreme Court of Canada" (1997) 28 Can Bus LJ 170 [Ziegel, "Section 224(1.2) in the SCC"] at 170–73; Campbell, *Administration 2012*, *supra* note 9 at 349–55.

The *Income Tax Act* clarifies that the garnishment provisions may apply to the federal and provincial governments.[291] In other words, the CRA may intercept payments from the government, garnish the wages of government employees, and so on. In the case of federal government departments, however, a requirement to pay is unnecessary, as the *Income Tax Act* also provides for set-off.[292] Using the statutory set off, any money owed to a tax debtor by a federal government department can be applied to the tax debt.[293]

4.1.2.3 Seizure and Sale of Chattels

The final arrow in the CRA's extrajudicial debt collection quiver is its power of seizure and sale. Subsection 225(1) allows the CRA to seize "goods and chattels" after giving 30 days' notice by registered mail.[294] The tax debtor has a further 10 days to pay before the goods may be sold, the proceeds applied to her debt, and any surplus returned to her.[295] In determining the goods that will be exempt from seizure, the *Income Tax Act* defers to the rules of the province in which the seizure is made.[296]

4.1.2.4 Third Party Liability

Like the United States, Canada's tax system provides liability for certain third parties in certain circumstances. Directors of a corporation can be held liable for amounts that should have been withheld and remitted by the corporation, transferees may be held liable for debts of the transferor, and legal representatives such as trustees and executors may be held liable for taxes they ought to have paid in the course of their duties. Each of

[291] *ITA*, *supra* note 3, s 224(1.4).
[292] *Ibid*, s 224.1.
[293] See IC98-1R4, *supra* note 281 at 2–3.
[294] *ITA*, *supra* note 3, s 225(1). Pursuant to s 226, the 30-day period is waived where the CRA suspects that the taxpayer has left or is about to leave Canada; however, notice must still be served, either personally or by registered mail to the taxpayer's last known address.
[295] *Ibid*, ss 225(2), 225(4).
[296] *Ibid*, s 225(5).

these is considered here, with an attempt to highlight the differences between the Canadian and American treatment of this topic.

4.1.2.4.1 Directors' Liability

While the United States puts responsibility for the remission of source deductions on whoever is responsible in the context for performing that task, the *Income Tax Act* imposes third-party liability on directors of a corporation. Directors are jointly and severally liable for any failure to deduct or withhold and remit certain amounts that the corporation was required to withhold and remit, the most significant being employees' source deductions.[297] However, there are procedural hurdles for the CRA to clear and statutory defences available to directors.

First, the imposition of liability on a director requires, roughly speaking, that the tax could not be collected from the corporation. This requirement is fulfilled where the CRA has registered a certificate in Federal Court and execution of that judgment has been returned unsatisfied.[298] Alternatively, if the corporation has commenced liquidation or dissolution proceedings, made an assignment in bankruptcy, or had a bankruptcy order made against it, directors can be liable where a claim for the corporation's liability has been proven within six months of the commencement of those proceedings.[299]

Where that hurdle has been cleared and the corporation's directors may be liable, there are additional barriers to collection. First, the CRA is obliged to begin proceedings

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[297] *Ibid*, s 227.1(1).
[298] *Ibid* at 227.1(2)(a). As discussed above, s 223 allows the CRA to certify an amount owing, register the certificate in Federal Court, and attempt execution as any other judgment creditor. It is worth noting that unsatisfactory attempts to use other statutory collection powers will not satisfy this requirement.
[299] *Ibid*, ss 227.1(2)(b), 227.1(2)(c).

no more than two years after a person ceased to be a director.[300] Second, the director will not be liable if she "exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."[301] The standard to be applied in judging due diligence is an objective standard, but one that takes into account the particular circumstances of the director.[302] For example, the courts sometimes distinguish between "inside" directors who are involved in running the operation and "outside" directors who sit on the corporation's board but are not involved on a day-to-day basis in its affairs.[303] Inside directors will have considerable difficulty establishing due diligence where appropriate source deductions have not been made, while it may be reasonable for outside directors to rely on the assurances of others.[304]

4.1.2.4.2 Transferees' Liability

Only certain transferees can be held liable for the debts of the transferor. Subsection 160(1) of the *Income Tax Act* applies where a person has transferred property to any of the following: her spouse or common-law partner, or a person who has since become her spouse or common-law partner; a person under 18 years of age; or a person with whom the transferor was not dealing at arm's length.[305] In those cases, the transferee

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[300] *Ibid*, s 227.1(4). Determining exactly when an individual ceased being a director may be a complex task. The resignation must be effective under the relevant corporate statute, which may require strict adherence to various procedural requirements. See: *Campbell v Canada*, 2010 TCC 100, 2010 DTC 1090, [2010] 3 CTC 2217 at para 22, citing *Zweirchke v Canada*, [1991] 2 CTC 2783, 92 DTC 1003. Moreover, one who has resigned but continues to perform the functions of a director or holds herself out to be a director may be liable as a de facto director. See *Bremner v Canada*, 2007 TCC 509, [2007] GSTC 113, 2007 GTC 999-82, aff'd 2009 FCA 146 393 NR 61; *Savoy v Canada*, 2011 TCC 35, [2011] GSTC 15, 2011 GTC 931.

[301] *ITA*, *supra* note 3, s 227.1(3).

[302] *Buckingham v Canada*, 2011 FCA 142; [2013] 1 FCR 86 at para 39.

[303] See, for example, *Smith v Canada*, 2001 FCA 84, 198 DLR (4th) 257 at paras 12–13.

[304] *Heaney v Canada*, 2011 TCC 429, 2011 DTC 1333, [2012] 1 CTC 2252 at para 16; *Smith v. Canada*, *supra* note 303 at para 13.

[305] *ITA*, *supra* note 3, ss 160(1)(a), 160(1)(b), 160(1)(c). It is worth highlighting that the statute is drafted such that the liability may attach even to children at arm's length from the primary tax debtor. Similarly, someone who later become the spouse of the primary tax debtor may have been at arm's length at the time the transfer was made.

is liable, jointly and severally with the transferor, to pay the transferor's tax liability up to the difference in value between the transferred property and any consideration given.[306] The CRA can make an assessment under section 160 "at any time", which has been held to mean that there is no limitation period.[307]

The transfer contemplated in section 160 includes more than gifts and sales for less than fair market value. The broad statutory language is as follows: "where a person has… transferred property, either directly or indirectly, by means of a trust or by any other means whatever".[308] It has been found to apply to the payment of a dividend, to the payment of family expenses and obligations, to the relinquishment of an interest in an estate, and to transfers made using corporations or trusts.[309]

Perhaps most notable in section 160 is the lack of restrictions on the CRA's ability to impose joint and several liability. There is no time limit, and the CRA's delay in making an assessment is not subject to judicial review.[310] There is no requirement that the transfer in question was made with an eye towards avoiding the payment of the tax debt.[311] Due diligence is not a defence under section 160.[312] The CRA is free to assess the transferee even if the transferor's debt was discharged in bankruptcy after the transfer

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[306] *Ibid*, s 160(1)(e).
[307] *Canada v Addison & Leyen Ltd*, 2007 SCC 33, [2007] 2 SCR 793, 284 DLR (4th) 385 [*Addison & Leyen*]. The taxpayer complained that the 12-year delay in making the assessment under s 160 had caused undue hardship and made it difficult or impossible for them to be indemnified by the primary tax debtor.
[308] *ITA*, *supra* note 3, s 160(1).
[309] See, for example: *Neumann v Canada*, [2009] 4 CTC 2205 (TCC); *Yates v Canada*, [2009] 3 CTC 183 (FCA); *Medland v The Queen*, 98 DTC 6358; *Algoa Trust v The Queen*, 98 DTC 405; *Larouche v Canada*, [2010] 4 CTC 202 (FCA); *Livingston v Canada*, [2008] 3 CTC 230 (FCA).
[310] *ITA*, *supra* note 3, s 160(2) provides the CRA the power to assess "at any time". See *Addison & Leyen*, *supra* note 307; See also: Elaine S Sibson, "Revenue Canada's Long Collection Arm: Jeopardy Orders, Section 160 Assessments, and Directors' Liability" (1989) 50 Can Tax Found 26:1 at 26:14.
[311] Sibson, *supra* note 310 at 26:14.
[312] *Wannan v Canada*, 2003 FCA 423, 312 NR 247 [*Wannan*] at para 3.

was made.[313] There is also no requirement that the CRA make any attempt to collect the debt from the primary tax debtor before assessing the transferee.[314] Because of these features, the Federal Court of Appeal has called section 160 "draconian" and noted that, in its use "there is always some potential for an unjust result."[315] Nevertheless, it is a valid and remarkable tool at the CRA's disposal.

4.1.2.4.3 Trustees, Executors, etc.

Canada holds trustees and executors personally liable for unpaid taxes. Subsection 159(1) makes a "legal representative" of a taxpayer jointly and severally liable with the taxpayer.[316] Legal representatives include trustees, executors, trustees in bankruptcy, or anyone who is "administering, winding up, controlling or otherwise dealing in a representative or fiduciary capacity" with the taxpayer's property or that of the taxpayer's estate.[317] The representative's liability is limited to the taxpayer's property in her possession or control, or, if the representative has distributed property, to the value of the property distributed.[318] To avoid personal liability, the legal representative is directed to apply for and obtain a clearance certificate before distributing the property.[319] The certificate states that all amounts which the taxpayer is or can reasonably expected to become liable have been paid, and that all amounts which the legal representative is or can reasonably expected to become liable have been paid.[320]

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[313] *Heavyside v Canada* (1996), 206 NR 206, [1997] 2 CTC 1, 97 DTC 5026. However, transfers that occur after a proposal has been accepted by creditors and approved by the court are not caught by s 160 (*Martel v Canada*, 2010 TCC 634, 2011 DTC 1069, [2011] 3 CTC 2038).
[314] Sibson, *supra* note 310 at 26:14.
[315] *Wannan*, *supra* note 312 at para 3.
[316] *ITA*, *supra* note 3, s 159(1).
[317] *Ibid*, s 248(1).
[318] *Ibid*, ss 159(1)(a)(i), 159(3).
[319] *Ibid*, s 159(2) uses mandatory language: "every legal representative … shall".
[320] *Ibid*; For more on clearance certificates, see: Canada Revenue Agency, Information Circular IC82-6R9, "Clearance Certificate" (25 November 2011); Campbell, *Administration 2012*, *supra* note 9 at 202ff.

4.1.2.5 Collection Restrictions, Exceptions, and Jeopardy

The *Income Tax Act* defines a "tax debt" as "any amount payable by a taxpayer under this Act."[321] This includes income tax, penalties, interest, withholding taxes, and source deductions. These are "debt[s] due to her Majesty and [are] recoverable as such in the Federal Court or any other court of competent jurisdiction or in any other manner provided by" the *Income Tax Act*.[322] That is to say that debt arises by operation of the *Income Tax Act* – it exists regardless of whether the Minister has assessed it.

However, in the normal course of events, the CRA must first assess tax and mail a notice of assessment before any step toward collection can be taken.[323] In most cases, the CRA is forced to wait 90 days from the date of the assessment.[324] If the taxpayer objects to the assessment, the CRA continues to be prevented from taking action to collect the amount in dispute until the dispute is resolved, either through the administrative appeals process or on appeal to the Tax Court of Canada.[325] During this period, the CRA is prohibited from commencing proceedings in court, certifying the debt, making a garnishment order, or seizing the tax debtor's property.[326]

There are exceptions to those collection restrictions. Two blanket exceptions are notable. First, assessments of amounts required to be deducted or withheld, such as payroll deductions, are not subject to the collection restrictions. Second, the CRA may take action to collect one half of the outstanding balance on an assessment of a large

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[321] *ITA*, *supra* note 3, s 222(1).
[322] *Ibid*, s 222(2).
[323] *Ibid*, ss 225.1(1), 225.1(1.1).
[324] *Ibid*. Note that some more rare types of assessment have a different collection limitation period.
[325] *Ibid*, ss 225.1(2), 225.1(3). The CRA may take collection action after the decision of the Tax Court is sent to the taxpayer, even if the taxpayer decides to appeal the Tax Court's decision to the Federal Court of Appeal.
[326] *Ibid*, s 225.1(1). Conspicuously absent from the list of forbidden collection action is set-off. The CRA does interpret the law to allow for the use of the statutory set-off power even while other collection actions are prohibited. IC98-1R4, *supra* note 281 at 3.

corporation within the 90-day period after the assessment in spite of the collection restriction, and, in some cases, more of the debt can be collected after the 90-day period but while the assessment is still in dispute.[327]

In addition to these blanket exceptions, the CRA can ask for the collection restrictions to be lifted in cases where the delay would jeopardize collection of the debt. Subsection 225.2(2) allows the CRA to make an *ex parte* application to a judge, and if the judge "is satisfied that there are reasonable grounds to believe that the collection of all or any part of an amount assessed in respect of a taxpayer would be jeopardized by a delay in the collection of that amount, the judge shall" authorize the CRA to use its full panoply of collection powers.[328] This "jeopardy order" may be made even where a notice of assessment has not been sent if the judge agrees that receipt of the notice "would likely further jeopardize the collection of the amount".[329]

While the application is made and the order issued *ex parte*, the taxpayer does have the opportunity to contest it after the fact. The taxpayer has the right to a hearing to review the jeopardy order. The judge is directed to "determine the question summarily" and "may confirm, set aside or vary the authorization and make such other order as the judge considers appropriate."[330] There is no further appeal from the judge's decision on review.[331]

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[327] *ITA*, *supra* note 3, ss 225.1(6)(b), 225.1(7). The other exemptions provided by s 225.1(6) are: the refundable tax payable in respect of scientific research and experimental development tax credit under Part VIII of the *ITA*; non-resident tax required to be paid by s 116 of the *ITA* or under a regulation made under s 215(4) of the *ITA*; and, interest and penalties related to those amounts.

[328] *Ibid*, s 225.2(2). The judge is usually a judge of the Federal Court, but may also be judge of a superior court of a province, see s 225.2(1).

[329] *Ibid*, s 225.2(3).

[330] *Ibid*, s 225.2(11).

[331] *Ibid*, s 225.2(13).

Since the enactment of amendments to *Income Tax Act* in 2004, there is also an upper limit on the amount of time that the CRA has to collect a tax debt. Starting usually with the end of the 90-day period discussed above, the CRA has ten years to collect.[332] However, this 10 year limitation period restarts if the taxpayer acknowledges the debt (in writing or by making a payment on account of the debt), the CRA commences collection action, or the CRA takes certain other actions, such as assessing a legal representative or a transferee in respect of the debt.[333] The time limit is also extended in certain cases, such as those in which the CRA accepts security in lieu of payment of a tax debt or the CRA is prevented from taking collection action because of bankruptcy proceedings.[334]

4.1.3 COMPARING COLLECTION POWERS

Simply looking at the statutory collection powers given to the CRA and the IRS, it is difficult to find any evidence for the hypothesis that the CRA's comparative reluctance to compromise is motivated by a comparative strength in its ability to collect. Both the IRS and CRA have extrajudicial processes allowing them to seize assets from the tax debtor directly and from third parties. Both impose liability on third parties in roughly similar circumstances. Both have mechanisms allowing the tax authorities to take swift action when the collection of the debt becomes jeopardized.

In considering collection restrictions, the IRS is prevented from assessing (and therefore collecting) where the taxpayer contests a notice of deficiency, while the CRA is only prevented from collecting the amount actually in dispute. On the other hand, the IRS itself has the power to determine when a jeopardy assessment or a termination assessment should be made, while the CRA needs to go to court to obtain a jeopardy order. However,

[332] *Ibid*, s 222(4).
[333] *Ibid*, ss 222(5), 222(6).
[334] *Ibid*, s 222(8).

the hearing for a jeopardy order is *ex parte*, and the judge generally will rely on affidavit evidence from the CRA and on the CRA's good faith.[335] Accordingly, CRA will be able to quickly obtain jeopardy orders with little difficulty in appropriate cases.

Comparing the abilities of the tax authorities to secure their interests yields a similar result. The federal tax lien is created automatically and made effective upon the filing of notice. In comparison, for the CRA to secure its interest requires going to court to register a certificate, and then making use of the avenues generally available to judgment creditors. Again, the CRA appears to have an extra step, and requires the involvement of a judge, but, given the direction that the *Income Tax Act* gives judges in these cases, the burden of this step is relatively minor.

Third party liability provisions in the United States apply to a larger class of people, offering the IRS more potential avenues for collection. Again, however, the difference should not be overstated. The Canadian provisions offer the CRA certain strengths as well, such as the absence of any time limit to make an assessment against a non-arm's length transferee, and the wide variety of transactions that may qualify as a transfer for the purposes of transferee liability.

The statutory collection mechanisms in both the U.S. and Canada are designed to allow the revenue authorities to collect as quickly and as efficiently as possible. However, many of the cases in which compromise, settlement, and forgiveness will come into play will be those where the collection powers are of little use because the taxpayer simply does not have the resources available to satisfy her debts. While the speed of the statutory collection powers may give the IRS and the CRA an advantage over other

[335] Sibson, *supra* note 310 at 26:5 – 26:8.

creditors before the formalized processes of insolvency are triggered, their positions in bankruptcy remain to be considered.

4.2 THE TAX AUTHORITY AS A CREDITOR IN BANKRUPTCY

4.2.1 UNITED STATES: A POSITION OF STRENGTH FOR THE IRS

In this section, I present a summary of the interaction between the U.S. Bankruptcy Code and the collection of tax debts.[336] As discussed above, tax claims in the United States are not treated as ordinary unsecured claims (they are, at the very minimum, secured by the lien). While there are a number of nuances that might be considered in a more complete treatment of American bankruptcy tax law, for the purpose of comparing the IRS's position in bankruptcy proceedings with the CRA's position in Canadian bankruptcy proceedings, I focus on two main issues: the priority given to tax claims and the dischargeability of tax debts.[337] Priority in discussions of bankruptcy and insolvency laws refers to the degree to which a claim (in this case, the government's tax claim) can be preferred to the claims of competing creditors. Dischargeability refers to whether the claim is dealt with in the course of the bankruptcy proceedings. If the tax debt is discharged, then the debtor has no further legal obligation to pay it, whether or not it was paid in full during the course of the bankruptcy proceedings.

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[336] The "Bankruptcy Code" being Title 11 of the United States Code.

[337] For more on issues related to bankruptcy and taxation in the United States, see: Darrell Dunham & Alex Shimkus, "Tax Claims in Bankruptcy" (1993) 67 Am Bank LJ 343; Paul B Geilich, "Essentials of Bankruptcy Tax Law" (1992) 66 Am Bank LJ 323; Craig A Gargotta, "Post-Petition Tax Compliance under the Bankruptcy Code: Can the IRS Enforce Tax Collection after Bankruptcy Is Filed" (2003) 11 Am Bankr Inst L Rev 113; Jack F Williams, "Rethinking Bankruptcy and Tax Policy" (1995) 3 Am Bankr Inst L Rev 153; Gregory Germain, "Discharging Income Tax Liabilities in Bankruptcy: A Challenge to the New Theory of Strict Construction for Scrivener's Errors" (2006) 75 UMKC L Rev 741; Oei, "Social Insurance", *supra* note 8; Stephen W Sather, Patricia L Barsalou & Richard Litwin, "Borrowing from the Taxpayer: State and Local Tax Claims in Bankruptcy" (1996) 4 Am Bankr Inst L Rev 201.

Before setting out the American treatment of these issues, it is worth briefly explaining that bankruptcy cases in the United States are generally referred to by the chapter of the Bankruptcy Code under which they are commenced. Chapter 7 deals with liquidation of the assets of either individuals or corporate entities. Chapters 9, 11, 12, and 13 all provide for reorganization, adjustment, or consolidation of debts for different groups. Chapter 9 bankruptcy proceedings are open exclusively to municipalities. Chapter 12 allows for the adjustment of debts for family farmers and fishermen. Chapter 11 is generally used for the reorganization of corporate structures, and chapter 13 deals with the adjustment of the debts of individuals (though individuals can make use of chapter 11 in some cases). The discussion below refers mostly to chapter 7 or "straight" bankruptcy, but also makes reference to reorganizations or adjustments under chapter 11 and chapter 13.

4.2.1.1 Priority for Tax Claims

The U.S. Bankruptcy Code provides a list of claims that will be preferred to other unsecured claims.[338] Eighth on the list are certain "unsecured claims of governmental units" including income taxes for which returns were due in the three years before the filing of the petition in bankruptcy, those that were assessed in the 240 days before the filing date of the petition, and those that were not assessed before the bankruptcy but are assessable after the commencement of the bankruptcy proceedings.[339]

This places the government's income tax claim behind unsecured claims for domestic support obligations, certain administrative expenses incurred by the estate,

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[338] 11 USC § 507(a).

[339] 11 USC § 501(a)(8). A discussion of the difficult nuances is available: Dunham & Shimkus, *supra* note 337. For example, determining when a return was due may be complex, particularly where extensions were granted.

certain claims for wages, salary, or commissions, and several other categories of unsecured claim, but ahead of all other unsecured creditors. Moreover, the Bankruptcy Code also subordinates tax claims secured by a tax lien to the same seven categories of debts, essentially by allowing those claims to make use of the government's lien.[340]

4.2.1.2 Discharge of Tax Debts

Debts are not always discharged in the course of bankruptcy proceedings.[341] In chapter 7 cases, only individuals can have their debts discharged – corporate debtors can not.[342] Similarly, a reorganization of a corporation or partnership under chapter 11 will not result in a discharge where the plan that is confirmed provides for the liquidation of all or substantially all of the bankruptcy estate's property.[343] In addition to these blanket restrictions, discharge of debts in chapter 7 cases can be denied for a variety of reasons that generally centre on financial dishonesty.[344]

Even where discharge of debts is granted, however, tax debts are often excluded. The same categories of tax debts that are given priority are not dischargeable.[345]

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[340] 11 USC § 724(b)(2). As one commentator writes: "This has the curious effect of 'securing' priority unsecured claims up to the amount of the tax lien in chapter 7 cases. If priority unsecured claims equal or exceed the amount of the tax lien, the tax is completely unsecured, which allows junior lienholders to be paid to the exclusion of an apparently senior tax lien." (Geilich, *supra* note 337 at 326).

[341] As Tabb notes, the discharge of debts in bankruptcy, now entrenched in our conception of bankruptcy, is a relatively recent innovation in Anglo-American law. See: Charles Jordan Tabb, "The Historical Evolution of the Bankruptcy Discharge" (1991) 65 Am Bankr LJ 325 [Tabb, "Evolution of Bankruptcy Discharge"]; Charles Jordan Tabb, *The Law of Bankruptcy*, 2d ed (New York: Foundation Press, 2009) [Tabb, *Law of Bankruptcy*] at 3.

[342] 11 USC § 727(a)(1). Because the chapter 7 proceedings will result in the complete liquidation of the assets of a corporation or partnership and the dissolution of the entity, no "fresh start" is needed. See: Tabb, *Law of Bankruptcy*, *supra* note 341 at 961.

[343] 11 USC § 1141(d)(3).

[344] 11 USC § 727(a) directs the court not to grant a discharge for reasons including: fraudulent transfers; failure to keep or preserve books, documents, or records; fraudulent actions such as making a false or presenting a false claim in the course of the bankruptcy process; failure to explain any loss or deficiency of assets; the refusal to obey a lawful order of the court or respond to a question approved by the court. See Tabb, *Law of Bankruptcy*, *supra* note 341 at 961–72.

[345] 11 USC § 523(a)(1)(A). Penalties related to those taxes are also exempted from discharge by 11 USC § 523(7).

Generally speaking, then, discharge can be granted for tax debts that are more than three years old, unless they were assessed less than 240 days before the bankruptcy. However, further exceptions apply. If the relevant tax return was not filed or was filed late and within two years of the start of the bankruptcy proceedings, discharge will not be granted.[346] If the relevant return was fraudulent or if the debtor made a willful attempt to evade the tax in question, then a discharge will not be granted.[347]

The general sense of the provisions related to the discharge of tax debts is that "[t]he policy of giving an honest debtor a fresh start in life [via the bankruptcy discharge] is subordinated to the goal of protecting the public fisc".[348] In reflecting on the effect of priorities for tax claims and non-dischargeability of tax debts, one commentator calls them "complementary".[349] That is, the priority is granted in the hope that the debts will be paid, and so the non-dischargeability of the tax debts will not prevent the debtor from receiving a fresh start.[350] Another reading would say that the two goals of the liquidation bankruptcy – "relief of debtors and equitable treatment of creditors" – are subordinated to, and perhaps undermined by, the goal of collecting as much tax as possible.[351]

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[346] 11 USC § 523(a)(1)(B).
[347] 11 USC § 523(a)(1)(C).
[348] Tabb, *Law of Bankruptcy*, *supra* note 341 at 976. Other debts that that receive similar exemptions include domestic support obligations and debts resulting from "willful and malicious injury", and student loans, among others, also receive exemptions from discharge. Tabb's characterizes the exemptions as reflecting "a hodge-podge of policy decisions by Congress either to punish the debtor for assorted bad acts (most intentional torts, for example) or to reward certain 'worthy' creditors (such as taxing authorities and alimony and child support claimants)" (*ibid* at 951).
[349] Barbara K Morgan, "Should the Sovereign be Paid First--A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy" (2000) 74 Am Bankr LJ 461 at 490; Even if this reading of the scheme is persuasive, it should be noted that some difficult questions of statutory interpretation arise when attempting to make sense of the relationship between the priority provisions and the discharge provisions. See, for example, Dunham & Shimkus, *supra* note 337 at 351–58.
[350] Morgan, *supra* note 349 at 490; Even if this reading of the scheme is persuasive, it should be noted that some difficult questions of statutory interpretation arise when attempting to make sense of the relationship between the priority provisions and the discharge provisions. See, for example, Dunham & Shimkus, *supra* note 337 at 351–58.
[351] For this statement of the two purposes of bankruptcy, see Tabb, *Law of Bankruptcy*, *supra* note 341 at 3.

4.2.2 Canada: CRA as an Ordinary, Unsecured Creditor in Bankruptcy

Canada's bankruptcy system also provides for both liquidation and reorganization procedures. In this section, I discuss the position that the Canada Revenue Agency has in these proceedings. Generally speaking, tax debts in Canada rank as ordinary, unsecured claims, and the CRA is treated as any other creditor. However, the exception to this general rule, which significantly improves the CRA's ability to collect, is the special place afforded to amounts that are required to be withheld and remitted.

4.2.2.1 Reorganizations under the *CCAA* and the *BIA*

The *Companies' Creditors Arrangement Act* (*CCAA*) is the vehicle for most large corporate restructurings in Canada and is sometimes said to be the equivalent of chapter 11 of the U.S. Bankruptcy Code.[352] Restructuring under the *CCAA* is only available to corporations or corporate groups that have more than $5 million worth of claims against them.[353] For debtors that do not meet this requirement, the possibility of reorganization under the *Bankruptcy and Insolvency Act* also exists.[354] In either case, the process is intended to result in a proposal that the creditors together (including the CRA) will vote to accept or reject. If the proposal is accepted, the obligations set out in the proposal replace those that existed previously. If the plan is rejected either by the creditors or by the court, the proceedings may continue and the various stakeholders may attempt to negotiate another plan. However, creditors may be inclined to ask the court to enforce

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[352] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 [*CCAA*]; Sharon Hamilton, Adrienne Oliver & Jessica Lyn, "Government Collection of Tax in the Insolvency Context" in *2012 Tax Dispute Resolution, Compliance, and Administration Report*, *supra* note 9, 18:1 at 18:3; Greg Boehmer, Kathleen Hanly & Eric Xiao, "Insolvency: Selected Income Tax Issues Relating to Debt Restructuring and Liquidation" (2009) 61 Can Tax Found 7:1 at 7:2; Christopher Stocco, Sean Wilson & Brooke Ko, "'Insolvency 101' and Related Tax Issues" in *2009 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2010) 8:2 at 8:5–8:6.

[353] *CCAA*, *supra* note 352, s 3(1).

[354] *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [*BIA*].

their claims (indeed, the CRA's extrajudicial collection powers mean that the CRA may not need to involve the court if no stay of collection is in force).[355] The debtor may also choose to commence, or the creditors may attempt to force, bankruptcy proceedings that will focus on liquidation and distribution of the debtors assets.

Restructuring schemes under both the *CCAA* and the *BIA* explicitly provide protection for the same debts that the CRA has the power to collect using the enhanced requirement to pay provided by subsection 224(1.2), the most significant being employee source deductions.[356] Unless the CRA waives the requirement, the court can not sanction a proposal that does not include full payment of these debts within six months. However, aside from this special protection for these debts, the CRA acts as any other creditor in the process would. It evaluates the proposal, votes accordingly, and is bound by the results of the vote.

4.2.2.2 Bankruptcy Proceedings

Again, there are two distinct issues to explore in relation to the CRA's position in bankruptcy proceedings: the priority given to tax debts and the circumstances in which tax debts are discharged by bankruptcy.

4.2.2.2.1 Tax Claims as Ordinary Unsecured Claims

Historically, the Crown enjoyed a privileged place in bankruptcy proceedings. However, in a large round of amendments to the bankruptcy system in 1992, most of the

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[355] *Ibid*, ss 69(1), 69(1.1) provide for an automatic stay of collection action, which is binding on the Crown and includes a prohibition on the use of the enhanced garnishment provision. However, in proceedings under the *CCAA*, *supra* note 352 the stay of collection action is not automatic. Pursuant to s 11.02, the debtor may apply for an initial stay of 30 days and then further stays for as long as the court considers necessary.
[356] *CCAA*, *supra* note 352, s 6(3).

Crown priorities were removed.[357] Currently, the general rule is that the Crown's claims – including CRA's tax claims – rank as ordinary unsecured claims. However, several exceptions exist that give the CRA a slightly stronger hand to play. Security interests that have been registered in a public registry system are still treated as secured claims.[358] So where the CRA has taken the steps of certifying the debt, obtaining a memorial in Federal Court and registering that memorial in a public registry system before the bankruptcy occurs, the Crown's interest will be protected.[359]

In addition to secured claims registered in a public registry, the CRA has the advantage of a statutory deemed trust for amounts that the debtor was required to deduct or withhold and remit to the Crown.[360] Again, the most significant of these debts are the source deductions that employers are required to remit on behalf of their employees. These particular statutory trusts, together with similar provisions of the *Canada Pension Plan*, *Employment Insurance Act*, and provisions of provincial statutes that have similar purposes, survive the broader rule that statutory trusts in favour of the Crown are not effective in bankruptcy proceedings.[361]

Working in parallel with the deemed trust provisions is the enhanced requirement to pay. A stay of collection proceedings pursuant to subsection 69(1) or 69.1(1) of the

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[357] For a discussion of the evolution of Canada's bankruptcy system, including the reforms of 1992 and 1997, see Jacob S Ziegel, "The Modernization of Canada's Bankruptcy Law in a Comparative Context" (1998) 33 Tex Int'l L J 1 [Ziegel, "Modernization of Canada's Bankruptcy Law"].
[358] *BIA*, *supra* note 354, s 87(2).
[359] However, the Crown's claim will be subordinate to those secured creditors with earlier-filed claims, see *Ibid*, s 87(2)(b).
[360] *ITA*, *supra* note 3, ss 227(4), 227(4.1).
[361] *BIA*, *supra* note 354, s 67(3), referring to: *Canada Pension Plan*, RSC 1985, c C-8, ss 23(3), 23(4); *Employment Insurance Act*, SC 1996, c 23, ss 86(2), 86(2.1). As others have noted, this favourable treatment is not extended to the statutory deemed trust created by the *Excise Tax Act*, *supra* note 56, ss 222(1), 221(3) for amounts of GST or HST collected on behalf of the Crown. See: Ziegel, "Modernization of Canada's Bankruptcy Law", *supra* note 357 at 14; Morgan, *supra* note 349 at 486; Hamilton, Oliver & Lyn, *supra* note 352 at 18:22–18:23.

BIA prevents the CRA from issuing a new enhanced requirement to pay.[362] However, where no stay is in place, nothing prevents the CRA from exercising the enhanced garnishment power.[363] Moreover, where an enhanced requirement to pay is already in place, the amounts that are covered by the enhanced requirement to pay (including those which are to be paid as they become due) are considered property of the Crown, and therefore do not become part of the bankruptcy estate.[364]

Before leaving the discussion of the Crown's preferences and priorities in bankruptcy, it is worth noting that speedy pre-bankruptcy use of the statutory collection powers by the CRA is not seen as an illegitimate evasion of the scheme of the *BIA*. In *I. Waxman & Sons*, the CRA sought and received a jeopardy order based explicitly on the debtor's impending receivership.[365] The receivership order, once granted, would stay collection proceedings and the Crown would be treated as an unsecured creditor.[366] Using the jeopardy order, the CRA exercised its garnishment power before the receiver was appointed. The debtor was later declared bankrupt, and litigation ensued between the trustee in bankruptcy and the Crown. The trustee argued, among other things, that the CRA's actions had given the Crown an improper priority contrary to the scheme of the *BIA*.[367] Both the Ontario Superior Court and the Ontario Court of Appeal rejected this line of argument and held that there is nothing improper in CRA exercising its statutory

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[362] *ITA*, *supra* note 3, s 224(1.2) begins, "Notwithstanding any other provision of this Act, the Bankruptcy and Insolvency Act, any other enactment of Canada, any enactment of a province or any law, but subject to subsections 69(1) and 69.1(1) of the Bankruptcy and Insolvency Act and section 11.09 of the Companies' Creditors Arrangement Act".
[363] Hamilton, Oliver & Lyn, *supra* note 352 at 18:22.
[364] *Toronto-Dominion Bank v Canada*, 2010 FCA 174, [2012] 1 FCR 197, aff'd 2012 SCC 1, [2012] 1 SCR 3.
[365] *I Waxman & Sons Ltd (Re)*, [2010] 1 CTC 259, 62 CBR (5th) 292, aff'd 2010 ONCA 447, 100 OR (3d) 561 [*Waxman (Ont. Sup. Ct.)*].
[366] *Ibid* at para 5.
[367] *I Waxman & Sons Ltd (Re)*, 2010 ONCA 477, 100 OR (3d) 561 at paras 45–52.

rights and collecting the debt in advance of receivership or bankruptcy proceedings. Both levels of court agreed that "[other] [u]nsecured creditors who had similarly executed on their judgments would be treated similarly. No unfair advantage has been conferred on the CRA."[368] So, while tax claims may prove difficult to collect in bankruptcy proceedings because of the low rank given to the Crown's claims, the CRA is free to use its statutory collection powers to win the pre-bankruptcy "race of diligence".[369]

4.2.2.2.2 Tax Claims Dischargeable, but "Tax Debtors" not Automatically Discharged

Like the American Bankruptcy Code, the *BIA* provides a list of debts that are not discharged in bankruptcy. Like the American list, it includes student loan obligations, domestic support obligations, and debts that result from certain intentional torts. Unlike the American list, the Canadian exceptions to bankruptcy discharge do not include tax claims.[370] However, since the coming into force of recent amendments to the *BIA* in 2009, bankrupts with large tax debts no longer receive an automatic discharge in bankruptcy.[371] While tax debts may be discharged, debtors who meet the following criteria are forced to apply for a discharge after waiting a minimum period: (1) the debtor

[368] *Ibid* at para 51, quoting *Waxman (Ont. Sup. Ct.)*, *supra* note 365 at para 29.
[369] I am unsure of the exact origin of the phrase "race of diligence" with respect to bankruptcy law; however, its use extends back at least to 1842. See "Decisions in Bankruptcy" (1842) 1 Pennsylvania Law Journal 6 at 7. The unsatisfactory nature of the "race of diligence" when a debtor becomes insolvent is still sometimes given as a key animating principle of bankruptcy law. See, for example, Tabb, *Law of Bankruptcy*, *supra* note 341 at 4.
[370] *BIA*, *supra* note 354, s 178(1).
[371] Automatic discharge is provided in *Ibid*, s 168.1(1). However, s 172.1 provides the exception for personal income tax debtors who have more than $200,000 of personal income tax debt and whose personal income tax debt represents 75% or more of the total unsecured claims. In that case, the debtor must wait a minimum amount of time and then apply for a discharge. E Patrick Shea, *BIA, CCAA & WEPPA: A Guide to the New Bankruptcy & Insolvency Regime* (Markham, Ont: LexisNexis, 2009) at 225–271.

owes a tax debt of more than $200,000; and (2) the tax debt represents 75% or more of the total unsecured claims.[372]

In these circumstances, the tax debtor must apply for the discharge and the court has the power to do any of the following: grant the discharge and impose conditions such as performing some acts or paying some amount; suspend the discharge; or, refuse the discharge.[373] In making its decision, the court is directed to consider the following list of factors:

> (a) the circumstances of the bankrupt at the time the personal income tax debt was incurred;
> (b) the efforts, if any, made by the bankrupt to pay the personal income tax debt;
> (c) whether the bankrupt made payments in respect of other debts while failing to make reasonable efforts to pay the personal income tax debt; and
> (d) the bankrupt's financial prospects for the future.[374]

The effect, then, is to put the burden on the tax debtor to justify the discharge of the tax debt, including with reference to her tax compliance prior to the bankruptcy. However, as others have noted, these provisions are like to apply only in rare cases where those with unusually high tax debts seek to misuse the bankruptcy process by paying other creditors instead of the government.[375]

4.3 Different Sites of Forgiveness

The CRA's collection powers afford them the potential of collecting debts quickly and efficiently, but the comparison here shows that this strong position does not provide a compelling explanation for the comparative reluctance of Canadian policy makers to

[372] *BIA*, *supra* note 354, s 172.1.
[373] *Ibid*, s 172.1(3).
[374] *Ibid*, s 172.1(4).
[375] Janis P Sarra, "Economic Rehabilitation: Understanding the Growth in Consumer Proposals under Canadian Insolvency Legislation" (2009), online: <http://papers.ssrn.com/abstract=1399610> at 44–45.

design compromise mechanisms into the tax system. The IRS has similar collection powers with similar goals, but American policy makers and academics still see compromise as a useful part of the tax system. Moreover, the American tax authorities have an arguably stronger position when the two bankruptcy systems are included in the comparison.

It is worth repeating that the discussion above is necessarily incomplete. To paint a complete picture of the abilities of two tax authorities to collect debts would require looking at a wide variety of factors that I have not considered here. For example, the tax authority's ability to collect would be influenced by the following: the remedies generally available to creditors at the sub-national level in each country; insolvency provisions, such as receivership, that are available at the sub-national level; differences in the typical behaviour of other creditors in the "race of diligence" situation; differences in levels of secured financing; and differences in the political constraints on aggressive tax collection strategies.

However, this consideration of the federal tax systems and bankruptcy systems of the two countries does offer a useful conclusion. Broadly speaking, the Canadian tax system refuses to compromise or forgive tax debts. Instead, it relies on insolvency and bankruptcy regimes to make decisions about when non-collection of a tax debt is appropriate. By holding the CRA to its duty to collect the full debt, but treating it as an ordinary unsecured creditor in bankruptcy, the Canadian tax system effectively outsources decisions about forgiveness to the bankruptcy system.

On the other hand, policy makers in the United States have opted to include the compromise mechanisms in the tax system. They give the tax authority responsibility for

making decisions about the forgiveness of tax debts. Moreover, American policy makers have, to some extent, removed from tax debts from purview of the bankruptcy system by giving them priority and by protecting them from discharge in bankruptcy.

The consideration of collection powers and bankruptcy systems in this chapter shows that the main difference we see is not that one country's tax authority has a stronger incentive towards compromise or forgiveness. Rather, each jurisdiction confronts the reality that taxpayers are sometimes unable to pay the amounts that the tax system demands of them. Canada locates the process of making decisions about taxpayer that can not pay outside the tax system in bankruptcy and insolvency regimes. The United States includes compromise in the tax system and removes it from the bankruptcy system.

It is worth repeating that the contrast is not quite so stark. Some tax debts are discharged in Chapter 7 bankruptcy cases, and the strong powers that the CRA has to collect source deductions in bankruptcy are significant. Nevertheless, the broadly applicable rules are revealing. There are sure to be a number of consequences that flow from the decision to use one mechanism or the other to forgive tax liability. These consequences reverberate through debtor-creditor law, bankruptcy and insolvency law, and tax law, among others. In chapter 5, I use the lens of tax policy to consider the implications of Canada's posture towards forgiveness as revealed in this chapter and in chapter 3.

CHAPTER 5: TAX POLICY IMPLICATIONS

5.1 THE TRADITIONAL TAX POLICY FRAMEWORK

The discussion thus far has looked at mechanisms in the Canadian and American tax systems that allow or forbid the settlement, compromise, or forgiveness of tax assessed. Chapter 3 looked in some detail at the administration of these programs. Drawing on the insights of Lon Fuller's work, I argued that the Canadian system forces the taxpayer and the tax administration into an adversarial setting at every turn, while the American system allows bargaining. In chapter 4, I added some context to the discussion by examining the powers of and the constraints on the tax administration as a creditor. Comparing the two jurisdictions, I suggested that American policy makers have chosen to use the tax system to make decisions about the forgiveness of tax debts, while the Canadian approach is to make those decisions elsewhere.

In this chapter, I return to some of the questions raised in the second chapter and look more closely at whether there might be a case for some compromise mechanism within the Canadian tax system. In chapter 2, I suggested three possible grounds for a forgiveness mechanism in the tax system: for administrative efficiency; as a counterweight to existing inequities; and, as a part of a larger social safety net. Here, I return to these questions, looking at the issue of compromise from the point of view of tax policy. I suggest that there is a reasonably strong tax policy case for allowing compromise in the context of tax collection in Canada. In considering the dispute resolution context, while I have suggested that there may be overlooked problems in the status quo, I conclude that I am unable to offer any satisfying alternative.

Generally speaking, taxation systems are analyzed using three criteria: equity, efficiency, and administrability. Equity is sometimes discussed as having horizontal and vertical components. Horizontal equity is shorthand for the idea that people in similar situations should be taxed similarly.[376] In our tax system (taxing individuals on the basis of their income), the implication is that individuals with the same income should bear the same tax. Vertical equity discusses the relationship between taxpayers who are differently situated. A better off taxpayer should pay more tax than one who is worse off. In Canada's system, an individual with a higher income should pay more tax than an individual with a lower income.

Horizontal and vertical equity are not always considered independent concepts.[377] Questions around the equal treatment of equals lead to questions about the appropriate different treatment of unequals, and vice versa. Nevertheless, the rubrics of horizontal and vertical equity can be analytically useful. Discussing vertical equity often leads to a debate about the degree of progressivity that is desirable in the tax system. On the idea of horizontal equity – treating like taxpayers alike – there can be less disagreement. Instead, the disagreement arises when we need to measure, in practical terms, the well-being of taxpayers in order to assess the same tax liability.[378]

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[376] Deciding how to measure "similarly situated" taxpayers is fraught with difficulty. As I explain in more detail below, many tax policy scholars have adopted "comprehensive income" as the best measure of well-being to compare (see: Robin W Boadway & Harry M Kitchen, *Canadian Tax Policy*, 3d ed, Canadian Tax Paper 103 [1999] at 53–54). However, arguments are made in favour of consumption as a better tax base, or for some measurement scheme that would include wealth. For some discussion of these issues, see: Joseph Bankman & David A Weisbach, "The Superiority of an Ideal Consumption Tax over an Ideal Income Tax" (2006) 58:5 Stan L Rev 1413; Deborah H Schenk, "Saving the Income Tax with a Wealth Tax" (1999) 53 Tax L Rev 423; Alvin Warren, "Would a Consumption Tax be Fairer Than an Income Tax" (1979) 89 Yale LJ 1081.

[377] Liam Murphy & Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (New York: Oxford University Press, 2002) at 37.

[378] *Ibid* at 38. "[i]t is a controversial question in economics just what the appropriate operational measures of degrees of horizontal equity might be. As Alan Auerbach and Kevin Hassett write: "From Musgrave … on, there is general agreement that horizontal equity is important, but little agreement on quite what it is."

Efficiency, in tax policy analysis, is generally taken to represent the idea that the tax system should avoid interfering with the proper functioning of the free market. That is, it should avoid influencing the decision making of taxpayers and distorting the efficient allocation of resources by the market. Efficiency in this context is sometimes called neutrality, indicating that the tax system should aim to have a neutral effect on the market.[379]

Administrability, sometimes called simplicity or administrative practicality, also refers to efficiency in a more everyday sense of the word.[380] The tax system should be as easy or as efficient as possible to administer. Generally, it is thought that this requires the system to be as simple as possible to keep both taxpayers' compliance costs and the cost of administering the system low. The tax system should be "efficient" in the sense of reducing the time, money, and effort it requires of the taxpayers and of the agencies that will enforce it (administrable), in addition to being "efficient" in the sense that it should avoid distorting the allocation of resources by the market(neutral).

While these are the three traditional goals of a tax system, not all provisions in a contemporary taxing statute are related to these goals. Both the *Income Tax Act* and the Internal Revenue Code contain what are known as "tax expenditures".[381] These are

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(citing Alan J Auerbach & Kevin A Hassett, "A New Measures of Horizontal Equity", NBER Working Paper No 7035 at 1, citing Richard A. Musgrave, *The Theory of Public Finance* (New York; McGraw-Hill, 1959).

[379] See, for example, Kim Brooks, "Delimiting the Concept of Income: The Taxation of In-Kind Benefits" (2003) 49 McGill LJ 255 [Brooks, "Taxation of In-Kind Benefits"] at 259, referring to equity, neutrality, and administrative practicality as the traditional evaluative criteria of tax policy.

[380] See, for example, David G Duff, "Disability and the Income Tax" (2000) 45 McGill L J 805 at 804, referring to the tax policy goals of equity, efficiency, and simplicity. Boadway & Kitchen, *supra* note 376 at 84 refer to administration costs or administrative simplicity. On the other hand, Murphy and Nagel prefer to consider simplicity as an aspect of efficiency, see: Murphy & Nagel, *supra* note 377 at 12.

[381] See generally: Stanley S Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures* (Cambridge, MA: Harvard University Press, 1973); Stanley S Surrey & Paul R McDaniel, *Tax Expenditures* (Cambridge, MA: Harvard University Press, 1985); Neil Brooks, Jinyan Li & Lisa Philipps, eds, *Tax Expenditures: State of the Art* (Toronto: Canadian Tax Foundation, 2011).

provisions that are formally part of the tax system but functionally equivalent to government spending. Through the tax system, Canada's federal government subsidizes students, transit users, home owners, volunteer firefighters, and many other individuals and activities.[382] The government could have chosen to support these activities in a number of different ways. For example, the government could create new public institutions, increase the funding to existing institutions, or, mail cheques to individuals. The government choses to provide tax credits or exemptions instead for a variety of reasons: to make use of an existing bureaucracy rather than creating a new one; to save expense of mailing cheques, or fulfill a political desire to make the spending more or less visible than it would otherwise be. Although these measures are included in the taxing statute and administered by the tax authority, it is analytical useful to think of them as government spending measures rather than tax measures.

While I will make use of the traditional analytical framework in this chapter, I note that its soundness is contested. As I described above, it typically involves divorcing the analysis of the taxation system from the analysis of government spending. While this keeps the scope of the analytical task manageable, it may be problematic to consider the equity of the taxation system while remaining entirely indifferent to how the government spends the money. Under this framework, a flat tax system in a jurisdiction that spends all of its tax money on foreign wars can be considered exactly as equitable as a flat tax system in a jurisdiction that spends all of its government revenue feeding and housing the poor.[383]

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[382] Canada, Department of Finance, *Tax Expenditures and Evaluations 2011* (Ottawa: Department of Finance, 2012), online: <http://www.fin.gc.ca/taxexp-depfisc/2011/taxexp11-eng.pdf>.
[383] Murphy & Nagel, *supra* note 377, ch 2.

Criticisms have also been levied at equity and efficiency.[384] Where they are accepted, they are often presented as contrasting goals, and so commentators differ regarding the weight each should be given.[385] Sometimes forgotten in our eagerness to trade equity for efficiency or vice versa are issues around administrability, which is not just an ideal the tax system must endeavor to meet, but a firm requirement. Whatever else it does, the tax system will be administered, and so tax academics will sometimes talk about "second-best" policies, which usually mean the best policies that can practically be realized.[386]

In the discussion below, I engage with the traditional analytical criteria in spite of the force of these criticisms. Any persuasive case for the incorporation of a forgiveness mechanism into the current Canadian tax system must engage with that system as it is and as it is currently understood and discussed. While we should keep in mind what may be missing or misleading about the traditional analysis, here it will be useful in discussing the effects that forgiveness or compromise might have on Canadian tax law and policy or in attempting to explain why Canada's tax system eschews such compromise.

5.2 COMPROMISE AS ADMINISTRABILITY

As I said in the second chapter, it seems fairly clear that a case can be made for compromise if we are concerned only with the net cost of tax collection, which I will take

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[384] For examples of critiques of the roles of equity and efficiency, see: Neil H Buchanan, "The Role of Economics in Tax Scholarship" (2012), online: <http://papers.ssrn.com/abstract=2094477>; Richard M Bird & J Scott Wilkie, "Tax Policy Objectives" in Heather Kerr, Kenneth J McKenzie & Jack M Mintz, eds, *Tax Policy in Canada* (Toronto: Canadian Tax Foundation, 2012) 2:1 at 2:12.

[385] See, for example: Victoria A Levin, "The Substantial Compliance Doctrine in Tax Law: Equity vs. Efficiency" (1992) 40 UCLA L Rev 1587.

[386] R G Lipsey & Kelvin Lancaster, "The General Theory of Second Best" (1956) 24:1 Rev Econ Stud 11. There is, for example, an interesting conversation about the implications of the second-best theorem developed in welfare economics on the idea of the comprehensive tax base, beginning with Boris I Bittker, "A 'Comprehensive Tax Base' as a Goal of Income Tax Reform" (1967) 80 Harv L Rev 925, and Richard Musgrave's response: R A Musgrave, "In Defense of an Income Concept" (1967) 81:1 Harvard Law Review 44.

to be a part of the discussion of administrability.[387] This argument has some overlap with the argument for economic efficiency – all else being equal, administration of the system at a lower cost would be "efficient" in both senses. However, I treat the two separately in order to have a clearer discussion below about the incentives that might be created by rules allowing for compromise. In this section, I suggest that in the context of debt collection and in the context of dispute resolution, there are cases in which compromise would allow the tax authorities to collect more money, to collect sooner, and to collect with less expense.

The reason that this is the most obvious ground for an argument in favour of compromise is that we would normally expect that, if allowed to compromise, the tax collectors would act as any other rational creditor and attempt to maximize the amount of money that they collect. In the collections context, the government could rationally weigh a tax debtor's offer, considering the amount of the offer, the amount it expects to be able to collect though the usual channels, the cost of collection action, the risks and costs of bankruptcy proceedings, and so on. With a reasonable appreciation of the various factors, we could then expect that the tax collector would, sometimes, conclude that the compromise would be the most cost effective solution.

A similar dynamic might exist in the dispute resolution context. We would generally expect litigants – including the Crown in other contexts – to consider offers to settle the litigation with a number of factors in mind, including the time and expense of litigation and the likelihoods of various possible outcomes. Again, these calculations are

[387] Whether this discussion fits nicely into the traditional framework of adminsitrability may be open to dispute. It is not entirely clear that we would think of a compromise procedure as improving "administrative simplicity", even if it did improve the "efficiency of administration" and "administrative practicality". I avoid the term simplicity for the purposes of this discussion.

sure to reveal some instances in which settlement will be a more cost effective way of resolving the dispute than litigation would be.

Several objections are obvious. First, while it may be useful to examine in isolation ways in which more tax could be collected earlier and more cheaply, this is obviously not the only goal of the tax administration. Enforcing the taxing statute requires both a concern for fairness among taxpayers and a concern for the incentives that might be created by the way that the system is administered. These become even more important because a lack of equity may undermine taxpayers' faith in the tax system and compliance with it and the government's financial gains could be lost. Similarly, if the way the system is administered creates perverse incentives or avoidance opportunities, the gains will be lost. Further, it is not entirely clear that Canada's system is not currently providing adequate opportunities for forgiveness to meet these goals. In the collections context, bankruptcy and insolvency proceedings, taxpayer relief provisions, and remission orders all provide some measure of forgiveness. In the dispute resolution context, cases do settle frequently, and, as I argued in chapter 2, it is likely that some of these are compromise agreements in substance, even if they meet the formal requirements of the principled basis doctrine. In fleshing out the argument below, I consider the implications of compromise in terms of both equity and neutrality and I suggest that a compromise system within the tax system would be preferable to the status quo.

5.3 Forgiveness as Equity

Accepting that we may gain from compromise in terms of the revenue collected for the cost, we might still be unwilling to accept the idea of making compromises – of forgiving the debts of specific taxpayers – on equitable grounds. After all, equity would seem to demand the application of the same set of rules to all taxpayers. That is, while we may save significant legal costs when we settle litigation or administrative costs when we compromise a debt rather than pursue collection, that compromise will have a cost in terms of equity. Compromise in a specific taxpayer's case will move the system away from treating like taxpayers alike. This is not necessarily fatal to the argument for compromise: we might, for example, satisfy ourselves that the cost to equity is small enough and the administrability gain is large enough to justify the trade-off. However, for those who, like the Carter Commission, view equity as the overriding goal of the tax system, such an argument will be unconvincing.[388]

In this section, my goal is to question the premise that a mechanism for the forgiveness of tax debts necessarily reduces the equity in the tax system. Looking particularly at Canada, I start by pointing out that the *Income Tax Act* should not be thought of as the paragon of equity. Moreover, because of the diversity of human arrangements, we should not ever expect a set of rules to be universally applicable with perfect equity. It follows that some divergences from the generally applicable rules might increase, rather than decrease, the equity of the system.

Shu-Yi Oei made a similar case in her efforts to justify and suggest reforms to the American offer-in-compromise program. In her analysis, she notes three types of "indeterminacy" in the American tax system that lead away from the notion that the

[388] *Carter Report*, *supra* note 9, vol 1 at 4.

amount of tax assessed should be "viewed as a neutral and equitable baseline without further investigation."[389] In discussing "baseline indeterminacy" she draws on the work of Liam Murphy and Thomas Nagel as well as critical tax scholars to question the idea that pre-tax market income can work as baseline for fair taxation.[390] Oei captures this point best when she says, "if… Person A – due to underlying social structures and known disparities – has put in the same amount of inputs (e.g., effort, education, and time) but earns less pre-tax income than Person V, then is it fair to tax them equally?"[391] "Policy indeterminacy" refers to the idea that choices are made in drafting the taxing statute (income inclusions, deductions, and so on) where, in some cases, there are several viable options.[392] She argues that any theoretically ideal tax base is compromised in practice, and so it is not "obvious that we should default to considering the sum total of all of these policy choices (that is, the assessed tax liability amount) as a per se equitable outcome."[393] Finally, "executional indeterminacy" in Oei's taxonomy refers to the idea that "idiosyncrasies and intricacies" of the tax system in operation may give rise to inequitable outcomes in practice.[394] If the amount of tax assessed pursuant to the taxing statute is not necessarily the most equitable result, then an effective and well-designed compromise program might be thought of as a "gap filler" to help correct inequities in the system.[395]

In making my argument here, I present similar ideas. While I present the ideas slightly differently, give more space to certain facets of the argument, and attempt to pay

[389] Oei, "Getting More", *supra* note 8 at 1092.
[390] *Ibid* at 1087–89, citing, among others: Murphy & Nagel, *supra* note 377; Anthony C Infanti, "Tax Equity" (2007) 55 Buff L Rev 1191.
[391] Oei, "Getting More", *supra* note 8 at 1088.
[392] *Ibid* at 1089–90.
[393] *Ibid* at 1090.
[394] *Ibid* at 1090–91.
[395] *Ibid* at 1092.

particular attention to how the argument might be applied to the Canadian income tax system, this section might be thought of as an endorsement of Oei's justification of the offer-in-compromise program.

Following that, I step back from the discussion of whether equity is either present or possible in the tax system and engage the assumption that the best proxy for equity would be perfect compliance with the taxing statutes and full payment of tax debts. Even assuming that the system is equitable, it must be conceded that compliance and collection are not perfect. The question then becomes whether the tax authority can, in effect, bargain to increase equity.

These two lines of argument apply to justify forgiveness with some force in the collections context, but, as I explain, fit somewhat awkwardly in the dispute resolution context. Still, I look at what lessons might be drawn from this discussion to apply in the resolution of tax disputes and consider whether compromise settlements of tax disputes might ever be thought of as equitable.

5.3.1 Measuring Ability to Pay

It is generally accepted that fairness in the tax system requires taxation in proportion to the taxpayer's ability to pay.[396] It is worth noting at the outset that both the slogan "ability to pay" as a rallying cry for those who favour a progressive income tax and the principle of taxation based on ability to pay have been the subject of significant criticism.[397] Henry Simons, whose name is often attached to the idea of the comprehensive tax base, on which he believed we could construct an equitable income

[396] *Carter Report*, *supra* note 9, vol 2 at 10.
[397] For a review of various arguments against ability to pay, see: Stephen Utz, "Ability to Pay" (2001) 23 Whittier L Rev 867.

tax, disparaged "ability to pay" as the conceptual underpinning.[398] Others see taxation based on the level of benefits received from the government as more efficient and more equitable, though impractical in a modern welfare state like Canada.[399] Many criticisms of the conceptual coherence of taxation based on ability to pay have been levied, leading some proponents of progressive income taxation to attempt other groundings for the same system, and others to refine and defend ability to pay.[400]

Here, I do not propose to engage in the debate around the concept of taxation based on ability to pay. I simply note that the idea has been broadly accepted and relay what I consider to be a fairly standard account of the way in which it is translated into an operational tax system. For the purposes of this section, the key point is that, in translating the concept of taxation based on ability to pay to a working tax system, there are numerous ways in which the practical necessarily departs from the ideal. These departures will exist even under the contestable assumption that we have an agreed upon and clear notion of what we mean by "ability to pay". Moreover, these departures are not mistakes that can be corrected. Our tax system is doomed to imperfection – it is the necessary by-product of moving from the conceptual into the operational.

One final note before the discussion of how the idea of ability to pay grounds Canada's income tax system: I do not believe that the claim here ought to be particularly

[398] Henry C Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938) at 43; However, as Dodge notes, the version of the ability to pay norm that Simon criticized was "an older (and vague) 'capacity' concept." See: Joseph M Dodge, "Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles" (2004) 58 Tax L Rev 399, n 7, citing Simons at 5-19.

[399] Bird & Wilkie, *supra* note 384 at 2:3.

[400] Dodge, *supra* note 398, writes in response to Murphy & Nagel, *supra* note 377 and, Deborah A Geier, "Time to Bring Back the 'Benefit' Norm?" (2004) 33 Tax Notes Int'l 899, who question the conceptual coherence of the ability to pay norm and argue for other norms to justify progressive income taxation. Meanwhile, Utz, *supra* note 397 at 905, concludes his review of thinking around ability to pay as follows: "the ability to pay tradition lives on as a piece of traditional disinformation, a license not to confront foundational issues, and distraction from the genuine difficulty of analyzing our shared assumptions about tax fairness."

controversial. After all, remission orders under the *Financial Administration Act* and the taxpayer relief provisions in the *Income Tax Act* are based on the premise that the tax system will, at times, work in unfair ways and that some discretion to offer relief is required.[401]

5.3.1.1 Operationalizing Ability to Pay

The *Carter Report* can be seen as an attempt to flesh out a tax system in which equity is the overriding goal and that goal is thought to require taxation in proportion to ability to pay.[402] The Royal Commission, like many others, saw an income tax using the Schanz-Haig-Simons definition of income as the best measure of an individual's ability to pay taxes.[403] Henry Simons put the definition as follows: "the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question."[404] Ability to pay also mandates at least some progressivity: the level of income necessary for basic maintenance or subsistence should be considered unavailable to tax, as it does not contribute to the taxpayer's ability to pay.[405] There are, therefore, at least two tax brackets and a progressive structure.[406]

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[401] *FAA*, *supra* note 27, s 23(2); *ITA*, *supra* note 3, s 220(3.1); IC07-1, *supra* note 75 at para 8.
[402] *Carter Report*, *supra* note 9, vol 1 at 4, vol 2 at 10, 17.
[403] *Ibid* vol 3 at 23, and, generally, chapter 7; Richard B Goode, *The Individual Income Tax* (Washington, DC: Brookings Institution, 1976) at 11, 21; Dodge, *supra* note 398 at 401–02, 449–50.
[404] Simons, *supra* note 398 at 50; This definition of income has been called "the cornerstone of modern income tax theory". See: Dodge, *supra* note 398 at 400, n 5. The idea is credited to Simons as well as Georg von Schanz and Robert Haig. See: Georg von Schanz, "Der Einkommensbegriff und die Einkommensteuergesetze" (1896) 13 Finanz-Archiv 1; Robert M Haig, "The Concept of Income: Economic and Legal Aspects" in Robert M Haig, ed, *The Federal Income Tax* (New York: Columbia University Press, 1921).
[405] Dodge, *supra* note 398 at 449–50.
[406] Many argue for more progression on the basis of the declining marginal utility of money. But, at minimum, any version of ability to pay must exempt subsistence income.

However, as a reader of the *Carter Report* will quickly realize, fleshing out the system within those parameters requires that difficult decisions be made. At times, it requires that the ideally equitable tax – the tax which would better reflect the taxpayer's ability to pay – be sacrificed in favour of the practical administration of the system or out of a concern for the incentives that the tax system might create. In many circumstances, there will simply be no practicable set of rules that is capable of adequately and fairly capturing the ability to pay of all taxpayers. Below, I present several examples to illustrate.

The first is the tax unit. The *Carter Report* suggested that using the family as the tax unit would be fairer because it better reflects the way that economic resources are actually distributed (or so the commissioners believed when they wrote in the 1960s).[407] That is, taxation based on family unit would be a better way to collect taxes according to the ability to pay of the members of society. The Royal Commission's solution included a "marriage penalty" – a higher tax liability for a married couple as compared on two individuals with the same incomes – to recognize the economies of living together. Those unhappy with the recommendation that creates a disincentive to marriage should remember, as Boris Bittker demonstrated, that the tax system can not be simultaneously progressive, neutral toward marriage, and, horizontally equitable toward couples.[408] The lesson here is that policy makers and designers of an income tax system need to make assumptions. The *Carter Report* would have had us assume that families pooled resources. Such an assumption would risk inequity toward those people for whom it is not true. Another resolution to the problem of family taxation would reflect another set of

[407] *Carter Report*, *supra* note 9, ch 10.
[408] Boris I Bittker, "Federal Income Taxation and the Family" (1974) 27 Stan L Rev 1389 at 1395–97.

assumptions, and would similarly risk inequity for those whose family arrangements fall outside of those assumptions.[409]

Another difficult decision that must be made relates to the tax period. As the *Carter Report* acknowledges, our decision to tax based on annual income is essentially arbitrary in terms of equity.[410] It reflects a balance of concerns about the administrative practicality of the system: the government's ongoing need for money, the administrative burden on the taxpayer in complying, the tax authority's needs for regular reporting, and so on. However, it is recognized that the one-year period (and perhaps any period) will create some inequity. Taxpayers who have more control over the timing of their income will be able to gain an advantage through deferral. Given a progressive rate structure, taxpayers whose income fluctuates year-to-year will face a high tax bill in years in which their income is high enough to be taxed at the higher rates, but which might not accurately reflect their ability to pay over the longer-term. Measures have been suggested and implemented to alleviate these inequities; however, none can escape the fact that the choice of period is essentially arbitrary. Or, at least, the bare idea of taxation in proportion to ability to pay does not prescribe any particular timeline. It invites us to consider other factors – efficiency, administrative practicality – and to attempt to mitigate inequity that is created by the choice of a period in other ways. Canada's Registered Retirement Savings Plan provides a measure of income averaging, generally working to

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[409] To quote Bittker: "theoreticians, whatever their backgrounds, cannot 'solve' the problem of taxing family income. They can identify the issues that must be resolved, point out conflicts among the objectives to be served, propose alternative approaches, and predict the outcome of picking one route rather than another... Once the citizenry casts the die, however, the expert is entitled to offer a postscript, namely, that the chosen soultion will itself turn out, sooner or later, to be a problem." *Ibid* at 1463.

[410] *Carter Report*, *supra* note 9 vol 3 at 241: "There is nothing sacrosanct about the measurement of income for tax purposes on an annual basis. The choice of the calendar year as the relevant time period is a matter of convention and convenience rather than principle."

move some income from high income earning years to lower income earning years.[411] The *Carter Report* recommended averaging incomes over blocks of no more than five years.[412] The idea of averaging over a lifetime is sometimes floated as the most equitable, though it might be difficult to implement, and, for its part, the Royal Commission was not convinced that equity required it.[413]

Having decided to tax individuals' incomes annually does not settle matters. Rather, it begs the question: what is income? Even if we have accepted the comprehensive tax base (the Schantz-Haig-Simons formulation noted above), there will be a plethora of details to work out what constitutes income in practice.

To take one example, the system will need to separate personal consumption, which by definition is included in income, from amounts spent in the process of earning income that ought to be deductible because we seek to apply the tax only on profit. As Bittker points out, advocates of the comprehensive tax base "cannot be blamed for the haziness of this distinction", it owes simply to the fact that "our lives are not so compartmentalized that … borderline items can be readily classified."[414] If real estate agents are all required to wear suits, then perhaps the cost of the suit (or the additional cost of wearing a suit rather than some alternative) ought to be deductible from real estate agents' incomes. We may feel differently, however, if we learn that a particular real estate agent enjoys wearing suits, and wears them even while she is not working. Many other examples of mixed business/personal expenses are conceivable: "the lawyer who

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[411] Michael J Daly, "The Role of Registered Retirement Savings Plans in a Life-Cycle Model" (1981) 14:3 Can J Econ 409.
[412] *Carter Report*, *supra* note 9, vol 3 at 277.
[413] *Ibid* vol 3 at 241; For further rebuttals of the belief that the correct period over which we should consider equity is the lifetime, see: Wilbur A Steger, "On the Theoretical Equity of an Averaging Concept for Income Tax Purposes" (1957) 13 Tax L Rev 211; Richard Schmalbeck, "Income Averaging after Twenty Years: A Failed Experiment in Horizontal Equity" (1984) 1984 Duke LJ 509 at 547ff.
[414] Bittker, *supra* note 386 at 952–53.

can use his secretary on personal errands; the physician who reads the *National Geographic* before putting it in his waiting room; the executive whose family occupies empty seats on a company plane."[415] No rule can satisfactorily treat each of these situations according to our notions of income or ability to pay. To be implemented, the system needs to make assumptions that will be reasonably fair for most taxpayers, most of the time.

Similarly, the tax system will need to deal with in-kind compensation. Employers regularly pay certain expenses for employees, and many of these will have some personal character. The task of deciding which of these ought to be included in the employees' income has been called "one of the most enduring problems in fashioning an equitable, efficient, and administrable income tax."[416] In a classic illustration, Friedrich Kleinwächter suggested considering a *Flügeladjutant* (regimental aide-de-camp) who is paid as an ordinary officer, but lives royally at no expense to himself.[417] He accompanies the prince to the theatre and opera, eats at the royal table, and so on. The employer has subsidized the employee's personal consumption, effectively increasing the employee's income. To add to the conundrum, however, we assume that the *Flügeladjutant* despises hunting and the opera.[418] A near-infinite variety of nuances may be added: perhaps the *Flügeladjutant* is forced to attend the opera, but has no other duties associated with it; perhaps he is forced to attend and to serve or protect the prince while there; perhaps he comes to enjoy the opera over the course of his employment. Kim Brooks effectively

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[415] *Ibid* at 952.
[416] Brooks, "Taxation of In-Kind Benefits", *supra* note 379 at 259.
[417] Friedrich Kleinwächter, *Das Einkommeen und Sein Vertelung* (Leipzig: CL Hirschfield, 1896). I have relied on Simons's recounting of the conundrum (Simons, *supra* note 398 at 53), as well as discussions in the following: Brooks, "Taxation of In-Kind Benefits", *supra* note 379; Utz, *supra* note 397.
[418] Simons, *supra* note 398 at 53.

shows that the situation is not as hopeless as Henry Simons believed, and it is possible to develop guidelines to fairly treat in-kind compensation while being guided by equity, neutrality, and administrative practicality.[419] However, the implication is that equity will, at least in some cases, be sacrificed for the sake of administrability or neutrality. Moreover, Brooks admits the obvious point that no tax system will ever treat in-kind income perfectly.[420]

I do not present these as specific problems to be solved, but rather as illustrations of the general point that perfection will always elude us. The income tax strives for equity, but the diversity of human arrangements means that the universal application of a set of tax rules will never produce a system that truly taxes all likes alike.

5.3.1.2 Ability to Pay in the Offer-in-Compromise Program

When a taxpayer is unable to pay her tax debt, the first instinct of the Canadian tax system is to assume that she is the author of her own misfortune. We assume that she chose to over-consume or make risky investments. In other words, we assume that the tax system correctly estimated her ability to pay, and her failures to pay are her own fault. However, as I suggested in the discussion above, we should be less confident in presuming that the tax system always works equitably.

In deciding whether to accept a compromise offer, the IRS looks at the taxpayer's current situation, considering all of the decisions the taxpayer has made, her misfortunes and windfalls, the amount she actually needs to maintain herself and her dependants and her prospects for earning money in the future. Here, the IRS refers to a taxpayer's "ability to pay", though not with any obvious reference to the complex academic discussion of

[419] Brooks, "Taxation of In-Kind Benefits", *supra* note 379; Simons, *supra* note 398 at 53.
[420] Brooks, "Taxation of In-Kind Benefits", *supra* note 379 at 306.

ability to pay as a norm grounding the income tax system.[421] In gauging ability to pay in that context, the IRS attempts to estimate how much it can reasonably expect to collect, given the taxpayer's assets and its judicial and administrative collection remedies.

The offer-in-compromise program's view of ability to pay is something like what Richard Goode called "the crudest sense" of ability to pay: "In the crudest sense, ability to pay means only the possession of resources that can be turned over to the state. A pauper can pay little in taxes whereas a millionaire can pay much."[422] Goode argued that ability to pay as a tax norm needed to convey something more. His attempt at a definition was as follows: "Ability to pay taxes is the capacity for paying without undue hardship on the part of the person paying or an unacceptable degree of interference with objectives that are considered socially important by other members of the community."[423] Still, in building a tax system based on this definition (or, in any case, some definition meaning more than simply having the resources to turn over to the government), it is not entirely clear that the "crudest sense" of ability to pay should be completely forgotten. While ability to pay should mean something more, where the "crudest sense" is violated – where the system demands much of a pauper – it might indicate that the system's estimation of that taxpayer's ability to pay is mistaken.

As I argued above, we can not assume that the tax system always does a good job of enforcing equity between taxpayers. Where a taxpayer is unable to pay, it might be that the rules, which are generally fair, did not adequately reflect her particular family situation or health care needs. Perhaps her occupation demands that she incur extraordinary expenses that are not recognized by the rules, or perhaps some disaster or

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[421] See, for example: Tax Topic 204, *supra* note 131; *IRM*, *supra* note 94, § 5.8.1.1.3.
[422] Goode, *supra* note 403 at 17.
[423] *Ibid* at 37.

misfortune has drastically affected her assets while leaving her tax debts intact. In short, it may be the case that some idiosyncrasy of her situation has made it such that the tax laws of general application do not produce an equitable result in her case.

In those cases, compromise would not reduce the equity of the system. On the contrary, to forgive some portion of those debts would be to correct inequities worked by the tax system and to enhance the overall equity of the system. To design a compromise system that actually worked to enhance equity may prove a significant challenge; however, at the first step, we should be able to admit that our tax system is not perfectly equitable and that, in some cases, forgiving a portion of a taxpayer's debt will be the most equitable course. The next step is to suggest that the pool of cases in which a taxpayer is unable to pay her tax debts is a reasonable pool to draw from in considering where the system may have gone wrong in estimating taxpayers' abilities to pay.

5.3.2 BARGAINING FOR EQUITY

The argument based on inevitable inequity in the tax laws may not be entirely convincing. However, the case for a compromise system can be made without it. Putting aside concerns about the inherent inequity in the tax system, the case for equity through compromise changes. It might be argued that the tax system is, if not perfect, at least perfectible.[424] If there are inequities in the system, it might be preferable to attempt to correct them, rather than implement a stopgap measure. Similarly, an optimist might hope that, over time and on a large scale, the various inequities in the system work themselves out. Even accepting inequity in the system, one might object that a compromise system risks exacerbating, rather than remedying, those inequities.

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[424] Tax lawyers and tax law scholars have been criticised for holding such a belief. See: Crane, *supra* note 16.

Whatever the reason for rejecting the argument for compromise in section 5.3.1, a model of compliance as equity might be more persuasive. Here, I return to a more traditional belief in the power of our concept of income to act as a good proxy for ability to pay and in the aptitude of the substantive tax laws to accurately define and measure income. On this view, in most cases, the correct application of the *Income Tax Act* produces something very close to an equitable result. While we posit an equitable tax code and equitable enforcement mechanisms, we are left with inequities caused by non-compliance.

If perfect compliance is the ideally equitable situation, the question then becomes whether the tax authority can bargain to improve compliance or increase collections. The answer is not as clear as it is when discussing administrative savings. Even if we are persuaded that there may be cases, in either the debt collection or the dispute resolution context, where full and vigorous pursuit of all available remedies costs more than it is worth and that a compromise would result in a better financial situation for the government, we might be willing to spend that extra money either in defence of correct assessments or in pursuit of debts for the sake of ensuring that each taxpayer pays her fair share.

However, there are at least two ways in which we might think about the tax authority bargaining to increase equity under these assumptions, both of which are contained in the American offer-in-compromise model. The first is to set the bar for compromise at an increase in the amount collected, as the offer-in-compromise program does. If we were thinking only in terms of the efficiency of administration, we might want the tax authority to make a rational economic decision based on the amount it could

collect through its collection powers, the cost of pursuing that collection, and perhaps the administrative cost of the compromise program. To increase the equity of the system, however, we would want to ensure that the accepted compromise narrows the gap between the tax assessed and the tax collected. That is, the taxpayer should offer more than the tax authority expects to be able to collect otherwise. By assumption, this increased collection will improve the equity of the tax system.

The first question about this proposition is how the taxpayer can be expected to pay more than the tax authority, with its formidable collection powers, would be able to collect. In the American context, part of the answer seems to be that taxpayers have a variety of resources that they can access to finance a compromise, but that are unavailable to the tax collector. To fund a compromise offer, they borrow from family, friends, or commercial lenders, or draw from retirement assets that the IRS would not otherwise levy or seize.[425] For whatever reason, the results in the American program show that accepted compromises, on average, allow the IRS to collect more than it is able to collect when it rejects the offer. Accepted offers also tend to result in more collection than the IRS collects on the general pool of debts that are still unpaid after two years.[426]

The bargain also has the potential to improve compliance over time, even if equity is sacrificed in the short term. If forgiving a tax debt creates some inequity in the current year (or over the past several years), but makes the system more equitable in the future, the result might be an increase in equity overall. The offer-in-compromise program

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[425] US, National Taxpayer Advocate, *2007 Report to Congress*, online: <http://www.irs.gov/uac/National-Taxpayer-Advocate%27s-2007-Annual-Report-to-Congress!> [*NTA 2007 Report*] at 379.
[426] See Oei, "Getting More", *supra* note 8 at 1083–85, summarizing findings in of the National Taxpayer Advocate. See: US, National Taxpayer Advocate, *2006 Report to Congress*, online: <http://www.irs.gov/uac/National-Taxpayer-Advocate%27s-2006-Annual-Report-to-Congress!>; *NTA 2007 Report*, *supra* note 425.

attempts something like that by making the compromise contingent on the forgiven taxpayer's compliance over the next five years.

I admit that this type of bargain may seem absurd. In exchange for the forgiveness of a debt which the tax authority did not expect to be able to collect, the taxpayer agrees to fulfill the obligations that were already imposed on her by law. Nevertheless, it appears to be effective in the U.S. context.[427] It is impossible to say whether a similar compromise system in Canada would yield similar compliance benefits; however, there are reasons to be optimistic. As noted in chapter 3, a settlement procedure would provide a mode of interaction between that taxpayer and tax authority that is not currently available, perhaps cause taxpayers to see the tax authority in a different light and encourage compliance among taxpayers who have only had the chance to interact with the CRA in an adversarial role. More concretely, it would provide another point of engagement between delinquent taxpayer and the CRA, provide an incentive for those taxpayers to be proactive in making contact with the CRA, and provide the CRA with more information about delinquent taxpayers, allowing it to make more informed decisions about collection and to improve both the compromise program and its treatment of debt collection generally.

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[427] "The IRS determined that 'approximately 80 percent' of taxpayers whose OICs were accepted between 1995 and 2001 remained in compliance with their subsequent filing and paying requirements" (US, National Taxpayer Advocate, *2009 Report to Congress*, online: <http://www.irs.gov/uac/National-Taxpayer-Advocate%27s-2009-Annual-Report-to-Congress!> at 205); similarly positive results were found in another study: US, Treasury Inspector General for Tax Administration, *Monitoring of Accepted Offers in Compromise is Generally Effective, but Some Improvement is Needed* (2004) at 1. Most recently, the National Taxpayer Advocate confirmed again that flexible payment options, and not the federal tax lien, are generally more effective at both collecting delinquent revenue and encouraging long-term compliance US, National Taxpayer Advocate, *2012 Report to Congress*, online: <http://www.taxpayeradvocate.irs.gov/2012-Annual-Report/FY-2012-Annual-Report-To-Congress-Full-Report> at 351.

Moreover, in discussions about sacrificing some equity in the present to gain compliance (and therefore equity) in the future, it is important to remember how much equity the system stands to lose. In the Canadian context, where the Crown's tax claims rank as ordinary unsecured claims and can be discharged in bankruptcy, the CRA may be able to successfully identify cases in which the government has relatively little to lose by agreeing to a compromise.

5.3.3 Settlement of Tax Disputes: The Equity of Splitting the Difference

The case for compromise settlement of tax disputes, if there is one, needs to be different. If the taxpayer involved in the dispute is able to pay the tax assessed, then the justification for compromise is weakened to the extent that it depends on the fact that the tax authority does not expect the debt to be paid in full. Further, the fact that the taxpayer disputes the amount of her tax liability does not necessarily provide a compelling reason to believe that the system has worked in unfair ways in her case, as I have argued that an inability to pay might.

However, as I noted in the second chapter, a rule that strictly forbids compromise settlements, while allowing "principled" settlements, runs the risk of giving an advantage to taxpayers who are better-advised. In practice, richer taxpayers will be able to afford better advice and to achieve better results in a principled basis settlement negotiation. Meanwhile, less well-off taxpayers, who are often self-represented in these disputes, will feel the full force of the principled basis doctrine. So, where something that might be more like contractual bargaining can occur where two parties are equally informed about the restrictions on the negotiation (the provisions of the *Income Tax Act*), taxpayers

without access to professional, experienced advisors will be stuck in an adjudicative relationship where the tax authority plays the role of the decision maker.

While I suggested in chapter 2 that this phenomenon is likely to exist, there is little data available to help discern its impact. In the absence of data, prescribing a solution is somewhat difficult. If better advised parties have a relatively free hand in negotiations already, then completely reversing the principled basis doctrine would have a progressive effect by allowing the less wealthy access to the same type of interaction with the tax authority. However, if the principled basis doctrine is at least somewhat effective, constraining even the very rich, the removing it might increase the advantage that those with more power and more money have in negotiations with the CRA when compared to those with less power and money in similar negotiations.

One potential solution would be an explicitly progressive scheme to allow compromise settlements. That is, we might allow compromise settlements only for taxpayers below a certain means threshold. While this might have a progressive effect, respecting vertical equity, it would seem problematic from the perspective of horizontal equity. In addition to the difficulties that compromise settlements might create for equity, as I discuss below, there may be problematic incentives created by a system in which tax disputes were commonly settled on the basis of compromise.

5.4 Neutrality: The Problematic Incentives Created by Compromise

5.4.1 Dealing with the Moral Hazard Objection

Even if we are satisfied that a compromise procedure would yield practical administrative benefits and that it might not violate equity, we may still have concerns about the incentives that such a procedure would create. Taxpayers might be more

inclined to make risky investments or increase their consumption where they know that forgiveness of tax debts is available. This is an application of the "moral hazard" concept that evolved from the study of insurance and is now commonly applied in many areas of law.[428] Broadly then, moral hazard refers to the "perverse consequences of well-intentioned efforts to share the burdens of life".[429] More concretely, in the area of insurance where the concept originated, moral hazard refers to the natural tendency to engage in riskier behaviour (or do less to mitigate risks) when the risks are insured.[430]

One way to think about a program like the offer-in-compromise program is as a mechanism for sharing the risks of default on tax debts, and so moral hazard concerns can be raised.[431] However, the literature on moral hazard also suggests the solution to these concerns. While, from one point of view, the offer-in-compromise program may appear generous – a large debt may be forgiven – the cost of participating is quite steep. There is both a fee and a non-refundable deposit as part of the application process. Moreover, having an offer accepted generally requires that the taxpayer offer more than the IRS could reasonably expect to collect using its substantial collection powers. This may require liquidating assets and changing lifestyles. The taxpayer also agrees to comply with the tax laws for the next five years. The moral hazard literature recognizes that

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[428] As Tom Baker, "On the Genealogy of Moral Hazard" (1996) 75 Tex L Rev 237 at 237 reports, the concept comes up in the law and economic analysis of such varied areas as health care, banking regulation, products liability, and business law.
[429] *Ibid* at 239.
[430] Steven Shavell, "On Moral Hazard and Insurance" (1979) 93:4 The Quarterly Journal of Economics 541 at 541; John Black, Nigar Hashimzade & Gareth Myles, *A Dictionary of Economics* (Oxford University Press, 2009) defines "moral hazard", in part, as follows: "The observation that a contract which promises people payment on the occurrence of certain events will cause a change in behaviour to make these events more likely. For example, moral hazard suggests that if possessions are fully insured, their owners are likely to take less good care of them than if they were uninsured. The consequence is that insurance companies cannot offer full insurance. Moral hazard results from asymmetric information and is a cause of market failure."
[431] Shu-Yi Oei develops the idea of tax non-collection as a form of social insurance in Oei, "Social Insurance", *supra* note 8. It is also discussed in section 5.5 below.

deductibles and coinsurance are ways of reducing the effect of moral hazard. The mechanism can be explained as follows: if moral hazard results from the difference between the actual loss and the loss as "felt" by the insured, the deductibles and coinsurance offers ways reduce the gap between actual loss and felt loss, and thereby reduce the moral hazard.[432]

In the case of the offer-in-compromise procedure, there should be little doubt that the forgiven debtor is made to feel the loss in a substantial and lasting way. In addition to the fee and the non-refundable deposit, offers are only accepted where IRS officials are satisfied that the offer represents substantially all of the debtor's ability to pay. The requirement of compliance for 5 years further ensures that the loss of tax revenue is "felt" by the debtor for some time. Moreover, it is worth keeping in mind that, in this context, imposing the full liability on the tax debtor is not generally considered to be an option. Thus, the gap that ought to be considered in discussing the moral hazard added by the compromise procedure is not the gap between the actual loss and the loss felt by the debtor, but the gap between the loss that would have been felt without the compromise (via bankruptcy, for example) and the loss felt through the compromise procedure.

5.4.2 INCENTIVES IN DISPUTE RESOLUTION

The incentives that would be created by compromise in the dispute resolution context are perhaps the best support for proponents of the principled basis doctrine. Because the cost of litigation is high, the financial incentive toward extrajudicial settlement of disputes is strong. However, if the CRA considered only the potential cost

[432] Baker, *supra* note 428 at 270.

of litigation, there would be a good case for settling nearly every dispute, and therefore a strong incentive for taxpayers to dispute their assessments.

The prospect of a tax discount for taxpayers who choose to dispute their assessments is perhaps the most troubling potential complication should the principled basis doctrine be overridden. If it resulted in a significant increase in tax disputes, it would risk undermining the cost savings of compromise. Moreover, it would exacerbate concerns about the horizontal equity of compromise by reducing the tax liability of those with the time, energy, and inclination to fight with the CRA, with no regard to their ability to pay.

The likely response to a problem of increased numbers of disputes would be to increase barriers to the dispute resolution process. However, the trend in Canadian tax law has been going the other way: to reduce barriers to access to the dispute resolution system, while ensuring (perhaps imperfectly) that dispute is resolved in accordance with the *Income Tax Act*. It is not at all clear that reversing this trend would have a beneficial outcome, though I hope to consider questions around access-to-justice issues in more detail in future research.

5.5 SETTLEMENT AS A TAX EXPENDITURE

As Shu-Yi Oei points out in the American context, the offer-in-compromise program might be thought of as social insurance.[433] Oei builds her analysis by analogy to the bankruptcy system, which, as she says, scholars have long recognized might be thought of as a form of insurance. The premiums, in this case, are built into the cost of borrowing. The risk of financial catastrophe, then, is shared among all who borrow, and

[433] Oei, "Social Insurance", *supra* note 8.

its victims have the chance to have their debts discharged though the bankruptcy process. By the same token, we might think of a system like the U.S. offer-in-compromise program as an insurance program ("social insurance" because it is mandated by the government). In this case, we would imagine the premiums built into the taxes that we all pay, and that the debt forgiveness built into the system insures us against the risk that we will be unable to pay our taxes.

In tax policy terms, we might think of such a program, when executed through the tax system, as a tax expenditure. That is, a government spending program offering financial relief to those who need it. In Canada, our governments do this in a variety of ways. One of those could be a tax collection system that offered forgiveness. In that case, the traditional tax policy framework would no longer apply, and the question would be whether the program made sense as a matter of public policy. There are several reasons to think that it might, depending on how it was designed.

If the program was able to target those individuals for whom it would do the most good, it would be a very effective policy tool. The ideal target group consists of those who are at serious risk of bankruptcy without the forgiveness, but are saved from it by the forgiveness. Those who would go bankrupt are the taxpayers for whom the program would have a very low cost to the government, thanks to its unfavoured position in bankruptcy proceedings. The benefits discussed above – increased collections in the short term and increased compliance in the longer term – could still be realized. Moreover, if forgiveness of tax debts saves the debtor from bankruptcy and gives them a better chance

to continue earning money, then it will also reduce the chance that they will be a burden on other parts of the social safety net, thereby saving costs elsewhere.[434]

5.6 A Compromise Outlet within the Tax System Would be Preferable to the Status Quo

One possible objection to the inclusion of more forgiveness in the tax system is that Canadian taxpayers already have several avenues to have their debts forgiven. Canadian policy makers have simply chosen to locate most of these outside the tax system for the sake of preserving the integrity of the system. Indeed, Canadian taxpayers have several possible avenues to pursue the compromise or settlement of their tax debts: the partial forgiveness under the taxpayer relief provisions; the total forgiveness possible with a remission order; and the discharge of the debt that might be accomplished using the *Bankruptcy and Insolvency Act*. However, none of these offers the combination of administrative simplicity and the ability to be tailored towards tax policy goals as a full compromise mechanism located within the tax system would.

Remission orders can be recommended by the CRA, through the Minister of National Revenue, but can only be given by the federal cabinet. According to the wording of the provision, remission orders are to be granted where "the collection of the tax or the enforcement of the penalty is unreasonable or unjust or that it is in the public interest to remit the tax or penalty."[435] The wording sounds something like the equitable stop gap that I suggest a compromise procedure might be, but it lacks any other benefits. It is a rather cumbersome process that risks appearing politically motivated. It does not

[434] Oei, "Getting More", *supra* note 8 at 1096.
[435] *FAA*, *supra* note 27, s 23(2).

benefit the government as a creditor in any obvious financial sense, and it does not create a process tailored to concerns around either administrability or neutrality.

The taxpayer relief provisions have similar properties. They may be less administratively burdensome than remission orders, but they offer little opportunity for the government to improve its position as a creditor. The amount of relief they can provide is limited. In most cases, requests for taxpayer relief need to focus on what circumstances prevented compliance, and not whether the taxpayer has the resources to pay the full debt.

When all else fails, the CRA accepts less than it is owed in bankruptcy proceedings. As discussed in chapter 4, most tax debts are treated as ordinary unsecured claims in bankruptcy. However, it is worth remembering that, prior to the insolvency, the Crown is not an ordinary creditor in an important sense. Other creditors have the option of working with the debtor to restructure or settle their claims. They have the option of accepting less than they are owed if it is in their interest. The CRA has strong powers to enforce collection prior to bankruptcy, but in terms of settlement, the CRA is constrained in a way that no other creditors are.

That the CRA participates in bankruptcy proceedings, at least in some cases, as an unusually disadvantaged ordinary creditor lends support to the idea that locating some compromise or settlement mechanism within the tax system could improve the efficiency of Canada's tax administration. That is, removing or reducing the CRA's constraints in pre-insolvency settlement of debts would, in the framework of the debtor-creditor relationship where bankruptcy proceedings loom, remove a disadvantage that CRA

currently has when compared to other creditors. In doing so, the Crown would have little to lose financially, but could stand to collect more money sooner in some cases.

The other reason to believe that incorporating some compromise mechanism into the Canadian tax system, rather than leave that function to bankruptcy, would produce gains in tax policy terms is that the mechanism could be designed with these concerns in mind. Bankruptcy and insolvency legislation is animated by a number of factors and concerns: a desire for the orderly settlement of debts, fair treatment of a creditors, a fresh start for the debtor, and so on. As discussed in chapter 4, the tax system receives some consideration as well. However, the primary concerns of the bankruptcy and insolvency regimes in Canada are not contiguous with the primary concerns of tax policy. According to one Canadian commentator, "insolvency law is concerned with the inability of a person to pay claims owing to others."[436] In response, some regimes concern themselves with the liquidation of the debtor's assets, and others are more preoccupied with preserving the viability of the debtor's business as a going concern.[437] Regimes may be more or less interested in the "economic rehabilitation" of the debtor.[438] There may be a plethora of other goals that insolvency regimes need to consider.[439]

In some cases, the goals of tax policy and of insolvency law are well-aligned. Both demonstrate sensitivity to economic efficiency and the functioning of the market, for

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[436] Roderick J Wood, *Bankruptcy and Insolvency Law* (Toronto: Irwin Law, 2009) at 2.
[437] *Ibid*.
[438] *Ibid*.
[439] *Ibid* at 4; Wood calls the goals listed in UNCITRAL, *Legislative Guide on Insolvency Law* (New York: United Nations, 2005) at 10–14 "secondary goals" -- the primary goals being the orderly and fair resolution of the insolvent's debts and her economic rehabilition. These primary goals are: (i) provision and certainty in the market to promote economic stability and growth; (ii) maximization of value of assets; (iii) striking a balance between liquidation and reorganization; (iv) ensuring equitable treatment of similarly situated creditors; (v) provision of timely, efficient, and impartial resolution of insolvency; (vi) preservation of the insolvency estate to allow equitable distribution to creditors; (vii) ensuring and transparent and predictable insolvency law that contains incentives for gathering and dispensing information; (viii) recognition of existing creditor rights and establishment of clear rules for the ranking of priority claims; (ix) establishment of a framework for cross-border insolvency.

example. However, the goals of insolvency regimes generally include fairness or equity among creditors, while tax policy aims at fairness or equity among all the members of society. And, naturally, an insolvency regime's practical concerns about the ease with which rules can be administered will be directed at that regime and not at the administration of the tax system. Accordingly, it stands to reason that the administrability of the tax system, as well as equity and efficiency, could be improved by taking some cases out of the hands of the bankruptcy system and putting them into the context of the tax system where a settlement mechanism could be designed with these concerns in mind.

5.6.1 The Problematic Case for compromise in the Dispute Resolution Context

While there is a strong case for the savings that the revenue authorities would reap from compromise in the resolution of tax disputes, many will worry that a move toward the compromise of tax disputes will have problematic effects in terms of equity and neutrality that outweigh any administrative gains. In an attempt to add to the conversation, I have argued that there may also be some overlooked inequities owing to the rule that disputes can only be resolved on a principled basis.

While I raise this concern, I also suggest that we do not have sufficient data to prescribe a solution with any confidence. We should expect that taxpayers with better professional advice will be able to negotiate more favourable "principled" settlement than those without good representation; however, the extent of this effect is unknown, and so a solution to correct this inequity is difficult to formulate. I posited two possible solutions above, but suggest that the incentives they would create for taxpayers are likely to outweigh (and possibly undermine) any gains.

While we might hope for better data that would allow us to look more closely at this issue, it is worth noting that the tax dispute resolution system has other measures in place that may be helpful. The informal procedure stream of tax cases, for example, is available to reduce the costs of dispute resolution for both the government and the taxpayer. Less well-off taxpayers are more likely to have tax disputes with smaller amounts at stake; so, to some extent the availability of the informal procedure will even the playing field. While taxpayers with more resources will be better able to settle disputes extrajudicially, the cost of judicial dispute resolution has been reduced for at least some taxpayers who lack resources.

5.7 Review of Design Considerations

While the case for some theoretical compromise program is made out above, the details of such a program would be significant. The discussion in this chapter has explored various possible justifications for compromise, and each might suggest slightly different criteria that a compromise program should consider. To conclude the chapter, I return to the various design considerations to examine the question of whether a program could be devised that would meet all of the goals.

To satisfy a concern about administrative practicality the program ought to accept offers where the result is a net gain for the fisc, taking into account the amount of the offer, the amount that the tax authority can reasonably expect to collect if it rejects the offer, the cost of pursuing those collection methods, and the cost of processing the compromise. There is a certain amount of uncertainty we can expect in performing this calculation. The amount of the debt that could be collected is never certain until the debt is either paid in full or discharged in bankruptcy. However, we can safely assume that

those charged with tax collection have enough experience to make a reasonable, educated decision about whether the compromise is likely to net more revenue than the exercise of their collection powers would.

However, an approach to forgiveness in the collections context that took equity seriously might require more of the taxpayer that seeks to have a debt forgiven. We might consider equity to have been sacrificed if the tax authority compromised simply to save the cost of fully pursuing collection action. On the other hand, if the compromise allows the tax authority to obtain as much or more than they expected to be able to collect, and assuming that the tax authority's expectations are informed and reasonable, it becomes very difficult to argue that the compromise has decreased the equity of the system. Even if the compromise creates inequities – perhaps because of the imbalance of information between the taxpayer and the CRA, the tax authority may underestimate the amount that could be collected – these temporary inequities might be acceptable if the taxpayer follows through on a promise to be compliant in the future, improving the equity of the system in the long-term.

Finally, we need to be concerned about the incentives created by a compromise system. To this end, the *Carter Report* recommended that all compromises made under an offer-in-compromise program be made public.[440] The American offer-in-compromise program currently requires an application fee and a non-refundable deposit, which are also likely to be helpful in curbing abuses of the program. I suggested above that we need not be overly concerned about the risks of moral hazard for two main reasons. First, while a program like the American offer-in-compromise program forgives a debt and thereby socializes the risk of inability to pay a tax debt, it also ensures that the tax debtor

[440] *Carter Report*, *supra* note 9, vol 5 at 149.

is made to bear as much of the loss as possible. While the actual loss is still greater than the loss felt by the debtor, the loss felt is significant. Second, these risks are already socialized in other ways. The discharge of tax debts in bankruptcy and the broader social safety net already provide tax debtors with some insurance against the risks of default. To be clear, we can not expect to eliminate the effect that the introduction of a compromise program would have. Where it is available, some taxpayers will, consciously or unconsciously, change their behaviour and end up relying on it. What I suggest, however, is that measures can be taken to reduce the frequency and intensity of this problem, as they are in the United States. Moreover, in the Canadian context where bankruptcy discharges tax debts, it seems that the tax authority has little to lose.

CHAPTER 6: CONCLUSION

This thesis explored issues around the forgiveness of tax debts in the United States and Canada from several different angles. Using these different analytical frameworks and different points of view, my goal has been to illuminate the Canadian approach to compromise in the tax system. To do this, I juxtaposed it against the American system, which has at least superficial similarities to the Canadian system, but a contrasting approach to forgiveness. Canada and the United States both come from the common law tradition and tax policy scholars in two countries make use of similar analytical frameworks. We have integrated economies, federal constitutional structures, and free trade. Yet, the American tax authorities are authorized to compromise in the settlement of tax cases, and the Canadian tax authorities are not.

An examination of the historical evolution of this situation revealed that compromise has always been a part of the American income tax system. However, at least in its early development, "[t]he United States income tax law has had relatively little influence on the taxation of income in Canada."[441] Canada's approach, on paper, if not always in practice, has been to hold the taxing authority to its statutory duty to strictly apply the taxing statute to all taxpayers, and not to accept any "extralegal reduction" in tax liability.[442]

Imposing the classification of legal processes developed by Lon Fuller onto the comparison, I argued that the American system makes use of different ways of ordering

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[441] *Ibid*, vol 3 at 65; The commissioners note that the first statute taxing income in Canada taxed "income ... from all sources", a fairly similar formulation to the American law taxing "all income from whatever source derived". However, Canadian courts interpreted "income" to exclude capital gains, following the British tradition. Meanwhile, "the United States courts ... evolved a concept of income which embraces all accessions to wealth except those expressly excluded in the legislation." (*Ibid* at 63–67).

[442] Burns & MacGregor, *supra* note 67 at 33:9.

the relationship between the taxpayer and the tax authority, allowing different modes of participation for the taxpayer in the tax system. When compared to the Canadian restrictiveness, the offer-in-compromise program looks like a contractual ordering system. Within parameters, the parties are allowed to bargain and to reach an agreement that each believes is in its interest. Canada, on the other hand, always has the taxpayer engaging in adjudicative processes in the tax system. First, the dispute is adjudicated by an auditor, then by an appeals officer, later by a government lawyer, and eventually in a courtroom, if the dispute is not resolved. At no point, however, is the government's representative really allowed to bargain to resolve the dispute. The Canadian tax system eschews a contractual mode of ordering between the taxpayer and the tax authority in the context of settlement discussions, where we might expect to find it. Even where the tax authority might have the statutory discretion to bargain, as with the taxpayer relief provisions, the clear view of the administration is that straightforward bargaining would be improper.

In chapter four, I added context to the discussion by looking at the ways that the tax authorities in the two jurisdictions are treated *qua* creditor. The two jurisdictions both give their tax authorities significant powers to collect tax quickly and efficiently. However, there are important differences in the ways that tax debts are treated in bankruptcy. One way to look at the jurisdictions as presented in chapters 3 and 4 would be that each confronts the reality that some tax debtors will be unable to pay in its own way. Canada refuses to offer forgiveness within the tax system, but discharge is possible in bankruptcy. The United States is willing to compromise in the tax system, but excludes the bankruptcy system from making decisions about the forgiveness of tax debts. While

several nuances take some of the force out of those broad generalizations, the generalization is still enlightening.

In chapter 5, I looked at the case for compromise in the tax system using the traditional evaluative criteria of tax policy. As I suggested first in chapter 2 and again in chapter 5, using the tax policy framework might convince Canadian policy makers to rethink the uncompromising stance adopted in Canada's tax system. The assumption that any forgiveness necessarily entails a compromise of equity is highly questionable; rather, a compromise program might improve the equity and the administrative practicality of the system.

One way to look at the differences explored here is through the lens of culture. Ann Mumford compared the tax collection cultures of the U.S. and the U.K. in *Taxing Culture*.[443] She explained the American "rough justice" approach to tax collection, and differences in attitudes towards tax evasion in the two countries. She wrote:

> "Rough justice" is defined as a system which sacrifices accuracy for satisfaction, though the use of imprecise computational methods which allow taxpayers to feel that they have escaped tax liability … taxpayers have the satisfaction of a form of "moral" if not "legal", cheating, and what the IRS loses in "equity" is retrieved in "fiscal efficiency".[444]

Mumford contrasts the American "rough justice" approach with the British approach, which expects precision in the calculation of tax liability.

Different attitudes toward compromise might also be seen through this framework of cultural difference. Like the British approach Mumford explores, the Canadian system places high value on the accuracy of the assessment. Refusal to compromise is seen then

[443] Mumford, *supra* note 8.
[444] *Ibid* at 38.

as a matter of fairness; each taxpayer should pay, precisely, her fair share as calculated under the taxing statute. The American taxing culture is more accepting of imprecision, and it follows that compromise of this already rough calculation of liability is not seen as threatening to the integrity of the system.

These cultural differences caution against the wholesale importation of something like the American offer-in-compromise program into the Canadian system. As I have argued, there is a strong case to be made on tax policy grounds for the forgiveness of debts in Canada's tax system; however, it would be a mistake to expect to be able to import the American procedure and have the positive experience and attitudes toward it that are visible in the American academic literature. Transplanting a legal mechanism from one jurisdiction to another is difficult, if not impossible, precisely because of cultural differences.[445] It is important to be aware that neither the tax policy framework nor the American experience, both of which recommend forgiveness in the tax system, tell the whole story of how the Canada's tax culture would react to something like the offer-in-compromise procedure being introduced into Canadian law.

Still, given the opportunities for forgiveness already available to Canadian taxpayers and the potentially low cost and high reward of increasing the availability of some of these processes within the tax system, further conversation around a compromise mechanism with the parameters I explored in chapter 5 would be worthwhile. While we need to sensitive to the particularities of Canada's tax culture and cautious not to expect a Canadian offer-in-compromise program to be the same as the long standing American

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[445] For some discussion, see: O Kahn-Freund, "On Uses and Misuses of Comparative Law" (1974) 37 Mod L Rev 1; Eric Stein, "Uses, Misuses--and Nonuses of Comparative Law" (1977) 72 Nw U L Rev 198; Pierre Legrand, "The Impossibility of Legal Transplants" (1997) 4 MJECL 111.

program, we could still expect a positive outcome in tax policy terms.[446] Moreover, the recent report of the Auditor General found that the amount of undisputed tax that the CRA is owed grew faster than government revenue between 2006 and 2012.[447] This finding was reported by the newspapers, and so the time may soon be ripe for a conversation about giving the CRA some flexibility to compromise in some cases.[448]

In any case, the primary overarching purpose of this project was not to argue for the importation of the American offer-in-compromise procedure. Rather, it was to explore differences between the Canadian and American treatments of forgiveness in the tax system and to use that exploration to illuminate features of Canada's tax system. The U.S. comparison has helped me to shed light on the way in which different forms of social ordering and used (and repressed) in the Canadian tax system and been helpful in examining the legal context in which forgiveness of tax debts occurs. Moreover, it has given me the opportunity to highlight the importance of administrative issues in tax law and tax policy, which are too often overlooked.

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[446] Legrand, *supra* note 445 at 120, arguing for the impossibility of "legal transplants" writes: "as it crosses boundaries, the original rule necessarily undergoes a change that affects it qua rule." In a different legal system, in a different legal culture, the meaning of the rule is bound to change, even if the bare text of the rule is transplanted. Arguing for sensitivity to context in attempting law reform via transplant, see: Kahn-Freund, *supra* note 445; Stein, *supra* note 445.

[447] Office of the Auditor General of Canada, "2013 Spring Report of the Auditor General of Canada" (2013). Total undisputed tax debt incresed 57% while government revenue grew 29%. The CRA also wrote off 47% more debt as uncollectible in 2011-12 than it did in 2005-06.

[448] Jason Fekete, "Canada Revenue Agency owed $29-billion as uncollected tax debt soars 60% since 2006 audit", *National Post* (25 April 2013), online: <http://news.nationalpost.com/2013/04/25/canada-revenue-agencys-uncollected-tax-debt-up-by-60-per-cent-since-2006-audit/>.

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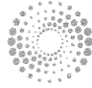

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