T-205-96

OTTAWA, ONTARIO, FEBRUARY 21 1997.

PRESENT: JOYAL J.

BETWEEN :

EMILE KUTLU

- and -

ARMEN DEUKMEDJIAN

Applicants

AND:

HER MAJESTY THE QUEEN

- and -

THE MINISTER OF NATIONAL REVENUE

- and -

MICHAEL L. QUÉBEC
in his capacity as Director
International Tax Services Office,
Revenue Canada, Customs, Excise and Taxation

Respondents

ORDER

The application for judicial review is allowed and the decision of December 27, 1995 is quashed. The matter is returned to the Director to be decided on the principle that subsection 220(3) of the *Income Tax Act* shall be construed as requiring that the applicants set out in their request for an extension of time the reasons why the return was not filed within the prescribed time, and that the respondents shall exercise their discretion in accordance with the ordinary rules.

Under Rule 1618 of the *Federal Court Rules*, costs, with some exceptions, are

not allowed. The applicants shall, then, bear their own costs.

"L. Marcel Joyal"

J.

Certified true translation

Christiane Delon

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REASONS FOR ORDER

JOYAL J.:

This is an application for judicial review under section 18.1 of the *Federal Court Act* seeking the quashing of a December 27, 1995 decision rendered by the Director of International Tax Services, Michael L. Québec ("the Director"), acting on behalf of the Minister of National Revenue ("the Minister"), refusing the request pursuant to subsection 220(3) of the *Income Tax Act* ("the ITA") for an extension of the times for filing the return of income for the 1992 taxation year.

The applicants request the following relief: (1) the quashing of the decision; (2)

an extension by any period needed for the adjudication of this application; (3) *mandamus* ordering the Director to do any act that he has unlawfully failed to do; (4) any other order considered just; and (5) costs.

Facts

In September 1988 Mr. Deukmedjian, a non-resident, purchased an 18-unit residential apartment building situated at 4278 Sherbrooke Street West, Westmount, Quebec ("the building"). Following the acquisition of the building, Mr. Kutlu was appointed agent responsible for the overall management of the building, including the filing of the relevant returns of income. To this end, Mr. Kutlu approached Revenue Canada to obtain the necessary information to discharge some obligations under the ITA. It should be noted that since the building was acquired it has generated nothing but losses.

Since 1989 the agent has had to file with the Minister a document entitled *Undertaking to file an income tax return by a non-resident receiving rent from real property* on a prescribed form NR-6, in order to be taxed only on the net rental income from the building. This involves two deadlines which, *prima facie*, appear rather rigid.

The first deadline, under the NR-6 undertaking, requires that the form be filed with Revenue Canada by the commencement of the fiscal year to which it relates. In this case, since the building is the private property of the applicant Armen Deukmedjian, the established deadlines follow the calendar year. However, the agent filed the NR-6 forms for the 1989, 1990 and 1991 taxation years around February or March of each of these years and Revenue Canada accepted the forms although they were filed after the established deadline.

The second deadline has to do with the filing of the income tax return itself, which is to be done within six months of the end of the fiscal year. The return for the

1989 taxation year was filed on July 9, 1990, the one for 1990 was filed on August 8, 1991, the one for 1991 was filed on November 9, 1992 and the one for 1992 was filed on November 21, 1993. For three of these years, 1989, 1990 and 1991, Revenue Canada accepted the tax returns filed beyond the established deadlines and sent notices of assessment indicating that no tax was payable. The return for 1992 is the subject of the present proceedings.

On April 14, 1992 the Minister sent the non-resident principal and the agent a letter approving the NR-6 form and reminding them of their undertaking to file the return within six months of the end of the taxation year in question.

On January 19, 1994 the non-resident principal was notified in a letter that the election to be taxed on net income rather than on gross income under subsection 216(4) of the *ITA* was not valid since the return had not been received within six months of the end of the taxation year, as required by that subsection. This letter stated that taxes and interest would be assessed accordingly.

On January 27, 1994, the agent sent a letter to Revenue Canada explaining that, although he had completed the NR-6 form undertaking to file an income tax return for 1992 before June 30, 1993, his tax guide for 1992 indicated that he did not have to file a return unless there was taxable income. Since the year had ended with a net loss of $24,593, the agent filed a late return as information only. He stated that he had filed in that way for the 1989, 1990 and 1991 years and received notices of assessment that did not indicate any problem with this procedure.

On February 10, 1994 Revenue Canada sent the agent a notice stating that it was proposed to impose an assessment of $31,867.25, or 25% of the gross rental income, against him personally. This notice stated that the assessment would be delayed by 30 days to enable the agent to communicate any information or explanation he considered relevant.

On February 15, 1994 Revenue Canada answered the agent's letter of January 27, 1994. Revenue Canada explained that since the return of income had not been received until December 23, 1993, the Department was not altering its position. It explained that there had been an amendment to the Act for the fiscal years ending after July 13, 1990, the effect of which was to make the filing of a return mandatory within the six-month period, and that a breach of this obligation resulted in a tax liability of 25% of the gross income, even in the absence of any taxable income.

On February 21, 1994 the agent wrote to the Department, deploring that in the course of the numerous communications he had had with Revenue Canada between 1990 and February 9, 1993, no warning, oral or written, had been conveyed to him concerning the date of return for the returns. Furthermore, he said, it would be unfair to impose on someone who had invested $1,000,000 in a building in Canada without receiving any profit an assessment of $31,000 because of a mere delay.

The respondent Michael Québec wrote to the non-resident principal ten months later, on December 15, 1994, denying him an extension of the time for filing the return of income. Mr. Québec explained that under subsection 220(3) of the *ITA*, an extension could be granted only "[*Translation*] when extraordinary circumstances have precluded an individual from filing an income tax return within the times set out in the Act". He further explained that in completing the NR-6 form, the agent undertook to file a return within six months of the end of 1992 and that otherwise he had undertaken to pay the full amount of tax prescribed by the *ITA*.

On February 1, 1995 the Minister forwarded a notice of assessment for the 1992 taxation year, holding the agent personally liable for the income tax on the building since he had not deducted the non-resident owner's tax under Part XIII of the *ITA* at the rate of 25% of the building's gross income on the sums he had paid to this non-resident. It appears that the gross income for that year was $127,469 and the tax at the rate of 25% on that amount came to $31,867.25 or $35,902.24 with interest.

On April 28, 1995 the applicants served Revenue Canada with a notice of objection to the assessment of February 1, 1995.

On June 1, 1994 counsel for the applicants asked the Director of the Montréal District office for an extension of the time for filing the non-resident principal's return. In a seven-page brief, including a summary of the facts deemed relevant and some submissions on the applicable law, counsel also requested an opportunity to meet with those responsible for the file in order to make the appropriate representations to them.

On August 29, 1995 the Deputy Director sent the applicants a letter explaining that the NR-6 form required a serious undertaking and that failing such an undertaking the agent became liable for a tax of 25% of the gross income.

On October 5, 1995 counsel for the applicants asked the Director to exercise the authority under subsection 229(3) of the *ITA* and to extend the time for making the 1992 return, saying they wished to have a personal interview in order to reply to the questions and provide more complete explanations.

Without holding an oral hearing, the respondent Michael Québec rendered on December 27, 1995 the decision in dispute, the one refusing to extend the time for making the return for 1992. This decision states:

> [*Translation*]
> As explained in our letter of December 21, 1994, an extension of the time for filing may be granted under subsection 220(3) of the *Income Tax Act* when extraordinary circumstances have precluded an individual from filing a return within the times set out in the Income Tax Act.
>
> . . . . .
>
> [Counsel for the respondents] indicates that you did not receive a reminder letter sent by the Department to all non-residents and their agents notifying them of their need to file. You must acknowledge that the Department was not required to issue these letters since form NR6 explains the undertaking of the non-resident and the undertaking of the agent and requires the signature of each of the parties in question. Accordingly, I am unable to grant you an extension of time for filing.

Applicants' submissions

The applicants submit that they had several reasons to think that the procedures they followed were consistent with the *ITA* requirements. In previous years they had filed their form after the established periods and, since the building was not generating any taxable income, they had also filed their income returns out of time, with no reaction from the respondents. This submission is based on the argument that the Department misled the applicants by:

(a)accepting the late filing of the NR-6 form for each of the 1989, 1990, 1991 and 1992 taxation years (after the first day of the year following the taxable year);

(b)accepting the income returns after the six-month period for the 1989, 1990 and 1991 years;

(c)issuing assessments for these years indicating that no income was taxable; and

(d)accepting the late returns and issuing assessments even after the change in the *ITA*.

The applicants argue that they were given no advance notice or opportunity to explain themselves in the context of a situation with serious tax consequences for them. They further submit that the officer making the recommendation to the Deputy Director recommended a decision favourable to the applicants, since "it seems that the agent was misinformed by the officer at the D.O. concerning filing requirements" and "financial hardship for agent". However, the review board and then the Deputy Director rejected this recommendation.

The applicants add that under subsection 220(3) of the *ITA*, the Department's guidelines provide for an extension of time under subsection 220(3) in certain circumstances, for example if a taxpayer was given erroneous information, provided that the discretion be exercised in a reasonable, fair and consistent way.

Respondents' submissions

The respondents, for their part, submit that the NR-6 form clearly establishes a six-month deadline and that the 1992 tax guide says the same thing on a careful reading.

Although the guide states that a person must file a return by April 30 only if he or she has to pay tax, it does explain that a non-resident who has received rent from real property and completed the NR-6 form must submit his or her income return by no later than June 30, 1993. They explain that the applicants are alleging not that they were given erroneous information, but that they were not made sufficiently aware of their undertaking under form NR-6.

The respondents explain that subsection 216(1) of the *ITA* was amended to make the filing of a return mandatory even if net income is nil. This amendment was made retroactive to the taxation years ending after July 13, 1990 but was not assented to until December 17, 1991. That, they say, is why the returns for the 1990 and 1991 years were accepted out of time.

The respondents say that all the relevant documents and all the circumstances were taken into account in rendering the decision. They further say that the applicants were reminded of their undertaking under the NR-6 form, in a reminder letter dated April 14, 1992. The favourable recommendation by the officer was not accepted since the officer had not noticed that this reminder letter, contrary to what the applicants say, had been sent to them.

Finally, the respondents add that the "extraordinary circumstances" referred to in the decision do not represent a higher burden of proof, but are rather an ordinary expression that is commonly used.

Analysis

The relevant part of subsection 216(1) of the *ITA*, as it reads since its amendment on July 13, 1990 (and assented to December 17, 1991) provides as follows:

> 216. (1) Where an amount has been paid during a taxation year to a non-resident person or to a partnership of which that person was a member as, on account of, in lieu of payment of or in satisfaction of, rent on real property in Canada..., that person may, within 2 years (or, where that person has filed an undertaking

> described in subsection (4) in respect of the year, within 6 months) after the end of the year, file a return of income under Part I in the form prescribed for a person resident in Canada for that year.... [emphasis added]

Should a return not be filed within the time provided in subsection 216(1), subsection 216(4) requires the agent to deduct 25% of the gross rent that should have been collected by him and to remit this amount to the Receiver General.

Through form NR-6, signed by the non-resident principal and the agent, the agent undertook as follows:

> I hereby undertake, if the non-resident fails to file a return and pay the tax according to the above undertaking, to pay to the Receiver General the full amount that I would otherwise have been required to remit in the year....

Accordingly, if the return is not filed on behalf of the non-resident within six months from the end of the year, the agent in Canada may be held liable and ordered to pay an amount equal to 25% of the gross rent from the real property. Counsel for the applicants raised an interesting interpretation of these provisions of the *ITA*, but I am satisfied that the above obligations apply in this case.

However, the Minister does have some discretion to accept the return even if it is filed beyond the time provided. Subsection 220(3) of the *ITA* states:

> 220. (3) The Minister may at any time extend the time for making a return under this Act.

No criteria are laid down as to how this discretion is to be exercised. However, it is clear law that in the exercise of a discretionary authority it is necessary not only to keep within the statutory mandate but also to consider all factors relevant to the statutory decision-making function.[1]

The non-resident owner income tax regime imposes a very onerous burden on the resident agent. The burden as such is not necessarily unfair since the agent is warned about it when making the undertaking in form NR-6. However, the operation of this

[1] *Oakwood Development Ltd. v. Rural Municipality of St. François Xavier*, [1985] 2 S.C.R. 164.

regime can impose an unreasonable penalty in some circumstances where the agent has taken all the necessary steps to comply with the Department's requirements. I am of the opinion that the discretion established in subsection 220(3) exists primarily in order to remedy the injustices that this regime could cause.

In the case at bar, the applicants made several inquiries of the Department's officers. The latter never indicated that there was any problem whatsoever with the late filing of the returns. For three years, the applicants filed their returns outside the six-month period established in form NR-6. For three years the Department accepted these returns without comment. On each occasion, the applicants thought they were justified in proceeding in this way since the tax guide stated that a return need not be filed within the time provided unless one had to pay tax, while they were not paying any. The Department concedes that prior to the return for 1992 filing out of time was allowed.

On December 17, 1991 an amendment to the *ITA* was assented to. On April 14, 1992 the Department sent a letter to the taxpayers who had signed the NR-6 form, not to notify them of a change in the Act, but simply to remind them of the undertaking they had made. The notice does not, therefore, answer the question of whether an extension of time should be granted.

The decision that is the subject of this application for judicial review is to the effect that the extension of time is not available unless some extraordinary circumstances preclude an individual from filing the return within the times established in the *ITA*. I am of the opinion that this decision does not answer the question. It is no answer to say that the time cannot be extended since the deadline has been missed; such reasoning begs the question.

In *Tic Toc Tours*,[2] the Court of Appeal had to consider a similar situation in which the taxpayer had failed to meet the deadline for filing his notice of objection. Under section 167 of the *ITA*, an extension of the time could be granted if the

[2][1983] 1 F.C. 254.

circumstances of the case were such that it would be just and equitable to do so. Subsection (2) states:

> (2) The application referred to in subsection (1) shall set forth the reasons why it was not possible to serve the notice of objection or institute the appeal to the Board within the time otherwise limited by this Act for so doing.

Notwithstanding the requirement that subsection 167(2) appeared to impose, Pratte J.A. explained:

> As I read the decision under attack, the member of the Board refused to grant the extension of time sought by the applicant because, as the evidence did not disclose that it had been impossible for the applicant to serve the notice of objection within the time limit, he considered that he was precluded by subsection 167(2) from exercising the discretion conferred on him by subsection 167(1).
>
> This decision is, in my view, founded on an error of law and must, for that reason, be set aside. The circumstances in which the Board is authorized, subject to the requirements of subsection 167(5), to exercise its discretion to extend the time within which a notice of objection may be served are described in subsection 167(1) which does not require that it should have been impossible for the taxpayer to serve the notice within the time limit. Subsection 167(2) is a procedural provision which merely requires, in my view, that the applicant set forth, in his application for an extension of time, the reasons why the notice was not served within the time prescribed.

Thus it would appear that the discretion to extend the time limited by the *ITA* should not be limited solely to a consideration of the circumstances which precluded the taxpayer from complying with the deadlines. In this case, we do not even have a statutory provision similar to 167(2) to suggest that possibility. The Director seems to have imposed this criterion himself and to have elevated it to the status of a decisive factor. There is no authority for this in the *ITA*, and the cases are opposed to exercising a discretionary authority in that way.

It is clear from the decision that the Director failed to analyze the file in the context of the factors on which he is deemed to have wished to exercise his discretion. Without taking a position on the precise applicable guidelines, I will take the liberty of saying that if the Director's reasoning is well founded, one might well ask oneself what circumstances could possibly trigger the application of subsection 220(3) of the *ITA*. The Director is mistaken if he bases his decision on the fact that the applicants failed to meet the deadlines, since these deadlines are essentially factors that bring subsection

220(3) into play. I would add that if this Court cannot supplant the Director's discretion with its own, it may nevertheless say that the record contains no indication of deceitful practices on the part of the applicants, and that counsel for the respondents was unable to suggest any adverse effect that might be suffered by her clients if an extension was granted.

Conclusion

The application is therefore allowed and the decision of December 27, 1995 is quashed. The matter is returned to the Director to be decided on the principle that subsection 220(3) shall be construed as requiring that the applicants set out in their request for an extension of time the reasons why the return was not filed within the time prescribed by the *ITA*, and that the respondents shall exercise their discretion in accordance with the ordinary rules.

Under Rule 1618 of the *Federal Court Rules*, costs, with some exceptions, are not allowed. The applicants shall, then, bear their own costs.

"L. Marcel Joyal"

J.

OTTAWA, Ontario

February 21, 1997

Certified true translation

Christiane Delon

FEDERAL COURT OF CANADA
TRIAL DIVISION

NAMES OF COUNSEL AND SOLICITORS OF RECORD

FILE NO. T-205-96

STYLE:EMILE KUTLU ET AL. v. THE QUEEN ET AL.

PLACE OF HEARING:OTTAWA, ONTARIO

DATE OF HEARING:JANUARY 13, 1997

REASONS FOR JUDGMENT OF JOYAL J.

DATED:FEBRUARY 21, 1997

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