



Attitude Against Tax Collectors Shows No Class

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The Canadian tax system forces the obligation to collect and remit certain taxes on businesses throughout Canada. The most pervasive of these obligations is that of collecting and remitting goods and services tax (“GST”), and now harmonized sales tax (“HST”), which requires that every recipient of a taxable supply (under statutory authority) collect and remit taxes on the value of the consideration of the supply. Generally, the collection of tax occurs at the point of sale. In so doing, the merchant acts as an agent of the Crown, but is entitled to no compensation.

The merchant takes on the obligation to ensure that the “appropriate” taxes are remitted and, if they are not, the merchant becomes subject to interest on unpaid amounts and is exposed to the possibility of personal liability for their directors.

Sometimes a merchant collects more tax than is due under a strict interpretation of the law. This can occur because the merchant collects where there is uncertainty in the application of the tax to a particular fact pattern, or where a change in law has occurred which subsequently demonstrates that a particular good or service is not subject to tax. This was recently illustrated in *Canadian Medical Protective Association v. The Queen*, a decision of the Federal Court of Appeal released in April, 2009 (“*CMPA*”).² The determination of the case was a surprise to many; the Court held that fees paid by the Canadian Medical Protective Association (the “Association”) in connection with discretionary investment management services constituted exempt financial services and were therefore exempt from GST, notwithstanding that many participants in the industry had believed they were taxable and had, therefore, charged GST on their supply. Consequently, the Association was entitled to recover the GST that had been paid on these management fees.

It was not surprising, therefore, that following the *CMPA* decision, several class action lawsuits were commenced by taxpayers seeking to recover erroneously collected GST from the collector (i.e., the investment manager). Unfortunately for those class actions, the federal government introduced retroactive legislation on December 14, 2009, which overturned the decision of the Federal Court of Appeal in *CMPA*.³ This legislation also imposed GST on certain financial services on a quasi-retroactive basis. If the taxes had been collected at the relevant time, the taxes would remain due and payable and, therefore, there was no argument that these taxes were never properly imposed. If the taxes were not collected, the law remained unchanged and, consequently, the taxes that were not collected were never owing. The legislation also imposed GST on a go-forward basis on the affected financial services.

The unfortunate thing is that merchants were caught in the middle. There is no upside to a merchant taking an aggressive position with respect to the application of exemptions. If the

merchant undercollects GST/HST and the Canada Revenue Agency (“CRA”) later audits that merchant and takes the position that the taxes were owing, the merchant will have to remit those taxes, notwithstanding that it may not have a practical method to go after its customers to collect it. On the other hand, if the merchant takes a conservative approach, there may be circumstances where the consumer is paying more tax than is reasonable under the law.

Two recent cases, one in the Ontario Court of Appeal and the other in the Federal Court of Appeal as well as a recent amendment to the *Excise Tax Act* (the “ETA”) regarding derivative actions against Crown agents, suggest that it is more difficult to bring such a class action suit than one might first imagine.

In *Sorbara v. Canada (Attorney General)*,⁴ the plaintiff claimed for recovery of GST it paid to a portfolio manager for services, which were ultimately determined to be financial services and, therefore, not subject to tax. The defendant moved for summary judgment on the basis that the Superior Court had no jurisdiction over the subject matter of the lawsuit. With respect to the jurisdiction argument, two grounds were put forward before the Ontario Court of Appeal. The first was that the Superior Court had a constitutional jurisdiction on the basis that the action alleged “unconstitutional conduct” by the taxing authorities, and the second was that the Ontario Superior Court had concurrent jurisdiction to adjudicate the claim with that of the Tax Court of Canada.

In answer to the question of constitutional jurisdiction, the Court of Appeal stated that the decision in *Kingstreet Investments Limited v. New Brunswick (Department of Finance)*,⁵ a case involving monies that had been collected under legislation which was itself *ultra vires*, was not applicable. The Court of Appeal observed that *Kingstreet* was not concerned with the proper forum in which to advance a claim, but rather with whether a taxpayer could recover monies that had been improperly paid to provincial governments under an *ultra vires* taxing statute where the province’s statute itself did not provide for a remedy. In *Kingstreet*, the Supreme Court of Canada held that a remedy did in fact exist. However, the Court of Appeal in *Sorbara* said it did not characterize the appellant’s claim as constitutional in nature and, therefore the Superior Court did not have jurisdiction to adjudicate the claim.

With respect to the alternative argument that the Ontario Superior Court had concurrent jurisdiction with the Tax Court of Canada to adjudicate the claim, the Ontario Court of Appeal found that section 12 of the *Tax Court of Canada Act* (the “Tax Court Act”), read in combination with sections 261 and 296-312 of the ETA, specifically excluded the jurisdiction of the Superior Court in language that was clear and unambiguous. Therefore, any challenge to the validity of the assessment must be made in the Tax Court of Canada. Further, the ETA provided an express remedy for a taxpayer who believed that an amount of tax had been paid in error. In the result, the Ontario Court of Appeal dismissed the appeal and held that it had no jurisdiction over the plaintiff’s claims.

Two recent cases, one a class action and one an appeal from an assessment of GST, both involving the Merchant Law Group LLP, a law firm with offices across Canada (“Merchant Law Group”), also addressed recovery of GST. At the Tax Court of Canada,⁶ the CRA sought to recover GST from the Merchant Law Group that had not collected GST on certain disbursements that the law firm had made on behalf of its clients. The Tax Court of Canada held that certain of

the disbursements at issue were exempt from GST and, therefore, the law firm did not have to charge GST on them. Following the trial decision and emboldened by its success, Merchant Law Group and another law firm (as well as certain of their clients) sought to commence a class action against the CRA and the Attorney General of Canada to recover all the GST that had been paid on such disbursements on behalf of all of its clients across Canada. That action was commenced in the Federal Court and was vacated by an order striking out the plaintiff's statement of claim as failing to state a cause of action.⁷

The FCA released its decision in the appeal of the Tax Court case concurrently with its decision discussed below regarding the aforementioned class action.⁸ The FCA allowed the appeal and assessed the law firm on failing to collect GST on behalf of its clients.⁹ That FCA decision is required reading for lawyers dealing with GST/HST on their disbursements.

In the class action appeal,¹⁰ the plaintiffs framed their action as a claim for restitution and for the tort of misfeasance in public office. The appeal raised two main issues: (i) had the appellants pleaded a viable cause of action, and (ii) was the appellants' pleading sufficient?

With respect to whether the appellants had pleaded a viable cause of action, the FCA framed the stated cause of action as recovery of taxes paid in error, as they were limited to the amount of GST that had allegedly been paid in error. It viewed the entire pleading as an attack on the amount of the tax that had been collected and that did not raise any other unrelated cause of action. The FCA compared the compensatory relief sought in the proposed class action with the relief that could be sought under Part IX of the ETA. The appellants claimed that they had paid GST and were of the view that the GST was not owing. When the Merchant Law Group rendered the accounts to their clients, they included the amount of the GST. Those clients, who were now the appellants, brought a proposed class action suit against the respondents seeking recovery of these GST amounts. The appellants wanted to be restored to the position they would have been in if the GST had never been charged. The FCA found that the Merchant Law Group could have challenged the Minister's assessment by claiming a refund (and the court noted that the law firm in question had, in fact, done that). The FCA also noted that under subsection 261(1) of the ETA, the clients had a right to claim a rebate for the GST overpayment. Such rebates, however, must be claimed within 2 years of the GST collected (see ETA subsection 261(3)).

The FCA went on to consider whether the claim for aggravated and punitive damages changed that characterization of the claim, so that it would not be viewed as a disguised claim for the recovery of GST. The claim did not disclose an attempt to recover damages, but instead requested recovery of just the amount of the tax. The court found that, "It still seeks the recovery of GST outside of the Act, but with an added penalty due to the respondent's conduct". The court stated that its conclusion should be tested by taking the amended statement of claim, removing everything concerning the recovery of GST, and looking at whether there is anything of substance left. The only claim left when the claim for recovery of GST is removed is that of harassment by the government, and there was no support provided to back up that claim. As a consequence, the FCA found that there was no viable cause of action.

The court's reasons are based substantially on that of *Sorbara*. In particular, FCA stated:

In *Sorbara*, the Court of Appeal for Ontario observed (at paragraph 7) that a superior court has jurisdiction to entertain any common law claim unless that “jurisdiction is specifically, unequivocally and constitutionally removed by Parliament”. The same is true for the Federal Court, with the only qualification (not material here) that the jurisdiction of the Federal Court, a statutory federal court, is conferred by the *Federal Courts Act*, R.S.C. 1995 , c. F-7 and constrained by the *Constitution Act*, 1867, section 101. The Court of Appeal for Ontario found that Part IX of the Act and section 12 of the *Tax Court Act* did qualify as a specific, unequivocal and constitutional removal of the superior court’s jurisdiction (at paragraphs 9 and 11):

The *Excise Tax Act* provides a complete statutory framework with respect to a taxpayer’s claim for a rebate of GST paid under Part IX of the *Excise Tax Act*. This framework also establishes the procedure that must be followed to challenge the validity of the assessment made by the Minister. That challenge must be by way of a Notice of Objection to the Minister and ultimately an appeal to the Tax Court.

The statutory provisions considered as a whole along with the explicit language in s.12 of the *Tax Court of Canada Act* leave no doubt that Parliament has given the Tax Court exclusive jurisdiction to deal with claims arising out of GST assessments and taxpayers’ claims for rebates of GST paid.

The court then agreed that the *Sorbara* decision was highly persuasive and directly on point and concluded that:

The only permissible way for the appellants to recover GST is to proceed to the Tax Court of Canada and follow the procedural rules and substantive standards set out in Part IX of the Act.

Like the Court of Appeal in *Sorbara*, the FCA also addressed the *Kingstreet* decision. The FCA distinguished the case at bar from *Kingstreet* on the basis that the Supreme Court of Canada in *Kingstreet* was fashioning a remedy because it had found that the taxpayer had recourse to a remedy as a matter of constitutional right (i.e., the right to be free of taxation, except taxation that had been properly levied under the Constitution). By its very nature, the claim was for restitution. What the Supreme Court of Canada allowed was a common law right of restitution to be used in circumstances where there is a constitutional remedy, and that remedy has not otherwise been specifically excluded by legislation.

Lastly, the FCA referred to the claims that were made with respect to the tort of misfeasance in public office. Having received full argument on the issue, the court thought that it was appropriate to offer *obiter dicta* comments on the issue. The FCA agreed with the Federal Court in its observations that:

When pleading bad faith or abuse of power, it is not enough to assert, baldly, conclusory phrases such as “deliberately or negligently” “callous disregard”, or “by fraud and theft did steal”. (references omitted)

The base assertion of a conclusion upon which the court is called upon to pronounce is not an allegation of material fact. Making bald, conclusory allegations without any evidentiary foundation is an abuse of process. (References omitted.)

Moreover, the Court added that the tort of misfeasance in public office requires that a public officer have a particular state of mind when carrying out the impugned action; there must be deliberate conduct which the public officer knows to be inconsistent with the obligations of his or her office. Pleading the tort of misfeasance in public office also requires naming the individual who committed the alleged misfeasance. The FCA recognized that such a requirement might be too onerous in many circumstances. However, the Court went on to state that where no individual is specifically identified, sufficient facts must be provided with respect to the individual to identify them. The FCA suggests that this could include a job description, an organizational branch or the office in which they work, or the matter in which they were dealing.

The goal is to give respondents enough information to investigate the matter and to adequately respond within the time limits required by the rules of civil procedure. Lastly, in what the FCA described as an “overactive submission”, the appellants suggested that the Court should relax the rules of pleading here because this was a proposed class action. The appellant suggested that the “Court of Appeal should view the pleadings not as it had been drafted but rather as how it might be drafted”. The Court of Appeal was not impressed by this argument, rejecting it and stating that there was no authority cited in its support. The Court stated:

The launching of a proposed class action is a matter of great seriousness, potentially affecting many class members’ rights and the liabilities and interest of the defendants. Complying with the Rules is not trifling or optional; mandatory and essential it truly is.

To that end, the FCA struck out the Statement of Claim and the potential class action. Because of the threat of class actions similar to these arising out of cases like *CMPA* and *Merchant Law*, a number of practitioners lobbied for stronger language than that contained in section 312 of the ETA. Section 312 reads as follows:

Except as specifically provided in this Part, the *Customs Act* or the *Financial Administration Act*, no person has a right to recover any money paid to Her Majesty as or on account of, or that has been taken into account by Her Majesty as, tax, net tax, penalty, interest or any other amount under this Part.

While the language of section 312 remains unaltered, Budget 2010 Bill C-47¹¹ amended the ETA to provide new section 244.1, which is substantially the same as subsection 227(1) of the Tax Act. Section 244.1 of the ETA, which came into force on December 15, 2010, reads:

(1) No person, other than Her Majesty in right of Canada, may bring an action or proceeding against any person for acting in compliance or intended compliance with this Part by collecting an amount as or on account of tax.

(2) Subsection (1) applies to any action or proceeding that has not, on or before July 13, 2010, been finally determined by the tribunals or courts of competent jurisdiction.

Notwithstanding this new provision, it is submitted that the result in *Sorbara* would not be affected. The language is clear and unequivocal and, by adopting it, the ETA demonstrates an intention to confine any adjudication of a tax matter to the Tax Court. In addition, section 312 of the ETA remains. For those who thought that section 312 of the ETA was insufficient, these cases are clear statements by the courts that they will not lightly interfere with the jurisdiction of the Tax Court or with the rights and remedies that are provided to individuals and businesses in the taxing statute itself. Particularly where the statute provides for a remedy to claim a refund, the taxpayer should use that remedy to collect any overpaid taxes.

There may be cases in the future where a taxpayer who is eligible to make a claim on behalf of a group of people, either because they are in a fiduciary position or otherwise, may find themselves as part of a class action lawsuit in which the claim may be a failure on the part of the person to properly bring a claim or to fight an assessment. For example, one can see a trustee being subject to a class action if the trustee overpaid taxes for which it reasonably expected to get a refund, and then never made a claim for that refund. In such a case, the claim will not be for recovery of the taxes, but for a breach of fiduciary obligation. One would expect that these cases will be isolated and infrequent. However, only time will tell.

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² 2009 FCA 115, aff'g 2008 TCC 33.

³ Amendments to subsection 123(1) definition of "financial service" in *Jobs and Economic Growth Act*. Royal Assent July 12, 2010 deemed in force December 17, 1990 subject to the stated applications therein.

⁴ [2009] G.S.T.C. 95, 98 O.R. (3d) 673 (Ont. C.A.). (Leave to appeal to the Supreme Court of Canada dismissed [2009] G.S.T.C. 158).

⁵ [2007] 1 S.C.R. 3 (S.C.C.) (hereinafter "*Kingstreet*").

⁶ *Merchant Law Group v. Regina* 2008 TCC 337.

⁷ *Merchant Law Group Stevenson Law Office, Anne Bawtinheimer, Duane Hewson, Judith Lewis and Marcel Wolf v. The Canada Revenue Agency and the Attorney General of Canada*, 2009 FC 755.

⁸ 2010 FCA 206.

⁹ Leave to appeal to the Supreme Court of Canada from the judgment of the Federal Court of Appeal was dismissed with costs on March 31, 2011. *Merchant Law Group v. Her Majesty the Queen* 2010 FCA 206, leave to appeal to S.C.C. refused, A-443-08 (March 31, 2011).

¹⁰ *Merchant Law Group v. R* 2010 FCA 184.

¹¹ Bill C-47: A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 4, 2010 and Other Measures was passed on December 7, 2010 and received Royal Assent on December 15, 2010.