# Discoveries in Tax Litigation

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*1716790 Ontario Inc v The Queen*, 2016 TCC 189

The Tax Court had to determine, *inter alia*, the correct scope of questions that must be answered by a third party (the individual shareholder of a corporate shareholder of an Appellant corporation) during discoveries.

Knowing the Rules applicable to the forum one is battling in is as important to success as knowing the substance of the law one is arguing and the facts one has to work with.

**FACTS**

The individual owned 100% of the shares of a corporation that owned 30% of the shares of the corporate Appellant. The issue was whether revenue from sales of retirement homes was business income or a capital gain. Thus the inquiry turned on whether the retirement homes were inventory or capital property.

During discoveries, on the advice of counsel, the individual refused to answer questions about his previous trading history in retirement homes. Taxpayer counsel took the position that the individual was a third party and that Rule 95(2) of the Tax Court of Canada Rules, General Procedure, requires that questions be reasonably related to the Appellant's affairs before the court, such that questions about the individual's trading history is personal information not reasonably relevant or merely a fishing expedition. The CRA felt that the individual was the controlling mind of the corporate Appellant, and therefore his personal training history was relevant.

**ANALYSIS**

The Tax Court recognised that the scope of discoveries is limited by Rule 95, including:

- The person examined has to answer all proper questions relating to any matter at issue in the proceedings to the best of their knowledge, information, and belief;
- They cannot refuse to answer on the basis that the information is hearsay, the question constitutes cross-examination, aims solely at credibility, or the question is cross-examination of an affidavit of the party; and
- The person, before the examination, has to make all reasonable inquiries regarding the matters at issue in the appeal, and may be required to become better informed for purposes of the discovery.

Rule 100 allows the Tax Court to order a person to answer questions, or make full answer to

questions, they have refused to (fully) answer. The court recognised that the general principles relating to the purpose and scope of discoveries are well established, though their application leads to disputes.

The purpose of discoveries is set out by the Federal Court of Appeal decision in *Canada v Lehigh Cement Limited,* 2011 FCA 120:

> The general purpose of examination for discovery is to render the trial process fairer and more efficient by allowing each party to inform itself fully prior to trial of the precise nature of all other parties' positions so as to define fully the issues between them. It is in the interest of justice that each party should be as well informed as possible about the position of the other parties and should not be put at a disadvantage by being taken by surprise at trial. It is sound policy for the Court to adopt a liberal approach to the scope of questioning on discovery since any error on the side of allowing questions may always be corrected by the trial judge who retains the ultimate mastery over all matters relating to admissibility of evidence; on the other hand any error which unduly restricts the scope of discovery may lead to serious problems or even injustice at trial.
>
> [emphasis added]

In short, the purpose of discoveries is to contribute to trial fairness for the parties and promote the discovery of truth by the court by allowing the parties to fully inform themselves of the other side's positions and evidence, so as not to be taken by surprise and to be able to help the court reach the correct conclusion.

Questions, just like evidence, are limited by the principle of relevance. In discoveries, a question is considered relevant if "there is a possibility that it will help the party asking the question, damage the position of the opposing party or lead to a series of questions that will accomplish one of the two precedent possibilities" (para 38). But a court may disallow relevant questions where the court determines that the potential value of the answer is outweighed by the risk that the asking party is abusing the discovery process, there would be undue hardship on the person examined, where there are other means of obtaining the information sought, or where the question is part of a fishing expedition (vague and far-reaching in scope) - *Merck & Co. v. ApotexInc.*, 2003 FCA 438 at paragraph 10; *Apotex Inc. v. Wellcome Foundation Ltd.,* 2008 FCA 131, at paragraph 3.

The Court referred to the summary of the principles provided by Justice Valarie Miller in *Kossow v Canada*, 2008 TCC 422:

> 1. The principles for relevancy were stated by Chief Justice Bowman and are reproduced at paragraph 50:

a) Relevancy on discovery must be broadly and liberally construed and wide latitude should be given;

b) A motions judge should not second guess the discretion of counsel by examining minutely each question or asking counsel for the party being examined to justify each question or explain its relevancy;

c) The motions judge should not seek to impose his or her views of relevancy on the judge who hears the case by excluding questions that he or she may consider irrelevant but which, in the context of the evidence as a whole, the trial judge may consider relevant;

d) Patently irrelevant or abusive questions or questions designed to embarrass or harass the witness or delay the case should not be permitted.

2. The threshold test for relevancy on discovery is very low but it does not allow for a "fishing expedition": Lubrizol Corp. v. Imperial Oil Ltd., [1997] 2 FC 3.

3. It is proper to ask for the facts underlying an allegation as that is limited to fact-gathering. However, it is not proper to ask a witness the evidence that he had to support an allegation: Sandia Mountain Holdings Inc. v. The Queen, [2005] 2 CTC 2297.

4. It is not proper to ask a question which would require counsel to segregate documents and then identify those documents which relate to a particular issue. Such a question seeks the work product of counsel: SmithKline Beecham Animal Health Inc. v. The Queen, [2001] 2 CTC 2086.

5. A party is not entitled to an expression of the opinion of counsel for the opposing party regarding the use to be made of documents: SmithKline Beecham Animal Health Inc. v. The Queen, [2001] 2 CTC 2086.

6. A party is entitled to have full disclosure of all documents relied on by the Minister in making his assessment: Amp of Canada Ltd., v. Canada, [1987] FCJ No. 149.

7. Informant privilege prevents the disclosure of information which might identify an informer who has assisted in the enforcement of the law by furnishing assessing information on a confidential basis. The rule applies to civil proceedings as well as criminal proceedings: Webster v. The Queen, 2003 DTC 211.

8. Under the Rules a party is not required to provide to the opposing party a list of witnesses. As a result a party is not required to provide a summary of the evidence of its witnesses or possible witnesses: Loewen v. The Queen, [2007] 1 CTC.

9. It is proper to ask questions to ascertain the opposing party's legal position: Six Nations of the Grand River Band v. Canada (Attorney General), [2000] OJ No. 1431.

> 10. It is not proper to ask questions that go to the mental process of the Minister or his officials in raising the assessments: Webster v. The Queen, 2003 DTC 211.

In HSBC, [6], it was said that hypothetical questions that require speculation or an expression of opinion should not be posed during discoveries, though:

1. The examining party is entitled to “any information, and production of any documents, that may fairly lead to a train of inquiry that may directly or indirectly advance his case, or damage that of the opposing party”: Teelucksingh v. The Queen;

2. The court should preclude only questions that are “(1) clearly abusive; (2) clearly a delaying tactic; or (3) clearly irrelevant”: John Fluevog Boots & Shoes Ltd. v. The Queen;

A fishing expedition "has been generally used to describe an indiscriminate request for production, in the hope of uncovering helpful information" (Harris, [9]). Thus, it's where "the plaintiff wishes to maintain his questions, and to insist upon answers to them, in order that he may find out something of which he knows he nothing now, which might enable him to make a case of which he has not knowledge at the present" (*Monarch Marking Systems Inc. v Esselte Meto Ltd,* [1984] 1 FC 641 (TD)).

When it comes to questions asked of third parties, the leading tax case is that of *Crestbrook Forest Industries Limited v Canada*, [1993] 3 FC 251 (FCA). The Court has the power to require answers from third parties, but should use this power only where "it is shown that it is in the interests of the administration of justice to look behind the corporate veil for the purpose of the case and only in special situation" (para 49). There is no requirement that the taxpayer be the alter ego of the third party to force the third party to answer. IF the information is relevant to the matters in the litigation, as defined by the pleadings, and it is in the interest of the administration of justice to make an order, the order should be made (para 57). The limits are threshold relevance, vagueness, hypothetical scenarios, broadness, over-reaching, abusiveness, undue hardship, and a fishing expedition (para 59).

The Court held that "a nominee should obtain the information in order to answer questions relating to a third party if the questions are relevant to the issues under litigation, if the third party is connected and interrelated with the appellant, and if it serves the interests of the administration of justice" (para 64). To determine relevance, one must look at the substantive law and see what information assists with establishing the matter - in this case intention of the

party is relevant to distinguishing between capital and inventory property. The intention of a corporation is that of the natural persons by whom it is controlled or managed - *Von Reality Ltd v Canada*, 2011 TCC 345; *Metropolitan Motels Corporation v. Minister of National Revenue* (1966), 66 D.T.C. 5208, [1966] C.T.C. 246 (F.C.T.D.); *Leonard Reeves Inc. v. Minister of National Revenue* (1985), 85 D.T.C. 419, [1985] 2 C.T.C. 2054 (T.C.C.).

In order to determine the intention of a corporation, the trading history of a controlling shareholder will be taken into account (para 68).

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