

**Federal Court of Appeal**



**Cour d'appel fédérale**

**Date: 20150415**

**Docket: A-113-14**

**Citation: 2015 FCA 95**

**CORAM: DAWSON J.A.  
WEBB J.A.  
NEAR J.A.**

**BETWEEN:**

**HER MAJESTY THE QUEEN**

**Appellant**

**and**

**ELEANOR MARTIN**

**Respondent**

Heard at Toronto, Ontario, on December 8, 2014.

Judgment delivered at Ottawa, Ontario, on April 15, 2015.

**REASONS FOR JUDGMENT BY:**

**DAWSON J.A.**

**CONCURRED IN BY:**

**WEBB J.A.  
NEAR J.A.**

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**REASONS FOR JUDGMENT**

**DAWSON J.A.**

[1] A judge of the Tax Court of Canada awarded costs to the respondent, Eleanor Martin, following her successful appeal from an assessment issued under the *Income Tax Act*, R.S.C. 1985, c. 1 (5<sup>th</sup> Supp.) (Act). The Judge's reasons in respect of the costs award are cited as 2014 TCC 50 (costs reasons); his reasons for allowing Mrs. Martin's appeal are cited as 2013 TCC 38 (appeal reasons). No appeal was taken from the Judge's decision allowing Mrs. Martin's appeal.

[2] As explained below, the Judge was critical of the conduct of the Canada Revenue Agency. He wrote at paragraph 16 of his costs reasons that he was surprised that Mrs. Martin's appeal proceeded to trial. While the Judge declined to award costs on a solicitor client basis, he did award costs to Mrs. Martin in excess of the relevant Tariff amount. The Judge did not explain how he calculated the increased costs. As I understand his reasons, the Judge included an allowance for costs Mrs. Martin incurred at the objection stage of her dispute with the Canada Revenue Agency.

[3] This is an appeal and cross-appeal from the Judge's costs order. On the appeal, the Crown argues that the Judge erred in principle in awarding increased costs. On the cross-appeal, Mrs. Martin argues that the Judge failed to reasonably exercise his discretion when he failed to order costs payable on a solicitor client basis including costs incurred in connection with the audit and objection stages.

[4] In my view, the following issues are raised by the appeal and cross-appeal:

1. What is the standard of review to be applied to the Judge's decision on costs?
2. Did the Judge err in principle in awarding increased costs?
3. Did the Judge err in principle in declining to award solicitor client costs as now sought by Mrs. Martin?

[5] Before I turn to consider the issues, it is necessary to briefly situate the issues in the relevant facts.

I. Factual Background

[6] Subsection 160(1) of the Act renders a taxpayer liable for income taxes owed by a tax debtor with whom the taxpayer was not dealing at arm's length if property is transferred to the taxpayer from the tax debtor for consideration less than the fair market value of the transferred property.

[7] The Canada Revenue Agency assessed Mrs. Martin as a result of payments received from her husband in the 1999 through 2004 taxation years. During those years Mrs. Martin's husband was indebted to the Minister of National Revenue on account of income taxes. Mrs. Martin appealed the assessment on the basis that she provided consideration for the amounts transferred to her in the form of services she provided to her husband's medical practice and premises she owned and made available to the medical practice. The Judge fully accepted Mrs. Martin's evidence (appeal reasons, at paragraph 2).

[8] Mrs. Martin began working in her husband's medical practice in 1989. She was paid a salary from 1989 to 1994 and in 2001 and 2002 (appeal book, at page 39).

[9] In his reasons, the Judge noted that:

- i. In a prior audit conducted in 1994, the Canada Revenue Agency accepted the reasonable arm's length value of the services provided by Mrs. Martin. The values accepted for the 1989, 1990, 1991 and 1992 taxation years were respectively: \$30,000.00; \$32,000.00; \$34,000.00; and \$36,000.00 (appeal reasons, at paragraphs 9 and 10).

- ii. The Canada Revenue Agency acknowledged that during the 1994 audit Dr. Martin was told that in future he could not pay a salary to his wife and deduct the amount of salary from his income (appeal reasons, at paragraphs 11 and 21). This was incorrect and contrary to the assessment that flowed from the 1994 audit.
- iii. As a result, thereafter Mrs. Martin was not paid in the years 1995 through 2000. In 2001 she was paid \$25,000.00 and in 2002 she was paid \$24,700.00 (appeal reasons, at paragraphs 10 and 11; cost reasons, at paragraph 5).
- iv. For each year in the period from 1995 through 2004 the reasonable amount of salary which would have been paid in an arm's length relationship for the services provided by Mrs. Martin was \$38,000.00 per year.
- v. Additionally, Mrs. Martin was owed \$37,500.00 by her husband in consideration of unpaid rent (appeal reasons, at paragraph 19).
- vi. In total, Mrs. Martin was entitled to additional consideration in the amount of \$267,800.00 from her husband. This was sufficient to allow the appeal and vacate the assessment (appeal reasons, at paragraph 20).
- vii. There are issues the Canada Revenue Agency should not pursue. This was a case where the essential facts were not in dispute. No new or novel argument was advanced by the Crown (costs reasons, at paragraph 21).
- viii. It was also relevant to the award of costs that prior to trial the Canada Revenue Agency credited Mrs. Martin for her unpaid services in the years in which the relevant transfers were made from Dr. Martin to his wife. However, the Canada Revenue Agency refused to recognize as consideration accrued unpaid services. This conduct was characterized by the Judge as inconsistent and irrational (costs reasons, at paragraph 22).

[10] It was agreed by the parties that under the relevant Tariff, Mrs. Martin was entitled to a counsel fee of \$4,800.00 and disbursements of \$634.23. Her actual legal fees before the Tax Court were \$4,625.00. Additionally, in the Judge's view it was relevant that after the Canada Revenue Agency became aware of the incorrect advice communicated to the Martins in the 1994 audit, Mrs. Martin paid legal fees of approximately \$21,000.00 to Thorsteinssons while pursuing her objection to the assessment. In total she paid approximately \$54,000.00 to Thorsteinssons and approximately \$12,000.00 to McInnes Cooper at the audit stage (costs reasons, at paragraphs 9, 10, 11, 12 and 23).

[11] It is in this context that the Judge awarded costs, inclusive of disbursements, in the amount of \$10,635.00.

[12] Having set out the relevant facts, I turn to the standard of review to be applied to the Judge's decision.

## II. Standard of Review

[13] Awards of costs lie at the heart of a trial judge's discretion. Discretionary costs awards should only be set aside if the judge made an error in principle, or if the award is plainly wrong: *Hamilton v. Open Window Bakery Ltd.*, 2004 SCC 9, [2004] 1 S.C.R. 303, at paragraph 27; *Sun Indalex Finance, LLC v. United Steelworkers*, 2013 SCC 6, [2013] 1 S.C.R. 271, at paragraph 247.

III. Did the Judge err in principle in awarding increased costs?

[14] The Crown asserts two errors on the part of the Judge: one of fact and one of law. The error of fact is said to be finding the 1994 auditor to have been deceitful when this finding was not supported by admissible evidence. The error of law is said to be relying upon the auditor's incorrect advice as a basis for increasing the costs awarded to Mrs. Martin.

[15] I see no merit in the first asserted error. The Canada Revenue Agency acknowledged in its Report on Objection that during the 1994 audit Dr. Martin was told that amounts paid in future to his wife would not be deductible in computing his business income. The Halifax office of the Canada Revenue Agency confirmed that this "warning" had been given to Dr. Martin (appeal book, at page 39). As noted above, this advice was given notwithstanding the result of the 1994 audit was to accept that the arm's length value of Mrs. Martin's services to be between \$30,000.00 and \$36,000.00 per year over a four-year period.

[16] To the extent that the incorrect advice and the consequences to Mrs. Martin that flowed from the incorrect advice could have been relevant, these facts were established in the evidence. In my view, nothing turns on the Judge's use of the word deceitful as he declined to award solicitor client costs.

[17] I now turn to the second asserted error.

[18] It is well-settled law that in exceptional circumstances conduct that occurs prior to a proceeding may be taken into account if that conduct unduly and unnecessarily prolongs the proceeding. See, for example: *Merchant v. Canada*, 2001 FCA 19, 267 N.R. 186, at paragraph 7; *Canada v. Landry*, 2010 FCA 135, 404 N.R. 255, at paragraph 25.

[19] Thus, in *Merchant* conduct at the audit and objection stages was relevant to the assessment of costs in the Tax Court because it impacted on the manner in which the trial proceeded. In the trial Judge's view, a trial that should have lasted no more than one day took seven days: *Merchant v. Canada*, [1998] T.C.J No. 278, 98 DTC 1734, at paragraph 59.

[20] This discretion to consider pre-proceeding conduct must, however, be exercised within the context of the Rules of the Tax Court. Here, the governing rule is Rule 147 of the *Tax Court of Canada Rules (General Procedure)*, SOR/90-688a.

[21] Rule 147 is set out in the appendix to these reasons. Briefly, Rule 147 allows the Tax Court to determine the amount of the costs of all parties to a "proceeding" (Rule 147(1)). "Proceeding" is a defined term. In Rule 2 it is defined to mean "an appeal or reference". In exercising its discretion on costs the Tax Court may consider a number of factors, including the conduct of any party that tended to shorten or to lengthen unnecessarily the duration of the "proceeding" (Rule 147(3)(g)) and whether any stage in the "proceeding" was improper, vexatious or unnecessary (Rule 147(3)(i)(i)). The Tax Court has discretion to award or refuse costs in respect of a "part of a proceeding" (Rule 147(5)(a)).



[22] Read in the context of the definition of “proceeding”, the Judge erred in principle in allowing an amount incurred in respect of costs unrelated to the appeal which were incurred at the objection stage. Those expenses, by definition, were not incurred as part of the appeal “proceeding”. The error is made manifest when one considers that it resulted in an award of more than twice as much as Mrs. Martin’s actual counsel fees for preparing, filing and pursuing her notice of appeal through to judgment in the Tax Court (costs reasons, at paragraph 15). As a result, I would allow the appeal and set aside the order as to costs issued by the Tax Court. It follows that the appellant should pay costs to the respondent in the amount of \$4,800.00 plus disbursements and taxes.

IV. Did the Judge err in principle in declining to award solicitor client costs?

[23] Mrs. Martin seeks an award of costs on a solicitor client basis in the amount of \$73,151.22 in order to indemnify her for costs incurred at the audit and objection stages as well as at the Tax Court.

[24] In my view, the cross-appeal must fail for the following reasons.

[25] First, it follows from the above analysis that an award of solicitor client costs in the proceeding before the Tax Court would not include costs incurred prior to the appeal to the Tax Court at the audit and objection stages.

[26] Second, even if the Tax Court could award solicitor client costs incurred prior to the commencement of an appeal before it, it is well-settled law that solicitor client costs are

generally awarded only where there has been reprehensible, scandalous or outrageous misconduct connected with the litigation.

[27] In the present case, the Judge did not view the conduct of the Canada Revenue Agency to warrant an award of solicitor client costs for the reasons set out at paragraph 17 of his costs reasons.

[28] Mrs. Martin has failed to show any error in principle on the part of the Judge. Nor has she shown that it was plainly wrong not to award her the costs she now seeks.

[29] For these reasons, I would dismiss the cross-appeal.

V. Costs

[30] The Crown asks that the appeal be allowed without costs. Therefore, I would not award costs in this Court. No costs are awarded in respect of the cross-appeal.

“Eleanor R. Dawson”

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J.A.

“I agree.  
Wyman W. Webb J.A.”

“I agree.  
D. G. Near J.A.”

Appendix

Rule 147 of the *Tax Court of Canada Rules (General Procedure)*, SOR/90-688a reads as

follows:

- |  |  |
|--|--|
| <p>147. (1) The Court may determine the amount of the costs of all parties involved in any proceeding, the allocation of those costs and the persons required to pay them.</p> | <p>147. (1) La Cour peut fixer les frais et dépens, les répartir et désigner les personnes qui doivent les supporter.</p>                    |
| <p>(2) Costs may be awarded to or against the Crown.</p>   | <p>(2) Des dépens peuvent être adjugés à la Couronne ou contre elle.</p>   |
| <p>(3) In exercising its discretionary power pursuant to subsection (1) the Court may consider,</p>  | <p>(3) En exerçant sa discrétion conformément au paragraphe (1), la Cour peut tenir compte :</p>   |
| <p>(a) the result of the proceeding,</p>   | <p>a) du résultat de l'instance;</p>   |
| <p>(b) the amounts in issue,</p>   | <p>b) des sommes en cause;</p>   |
| <p>(c) the importance of the issues,</p>   | <p>c) de l'importance des questions en litige;</p>   |
| <p>(d) any offer of settlement made in writing,</p>  | <p>d) de toute offre de règlement présentée par écrit;</p>   |
| <p>(e) the volume of work,</p>   | <p>e) de la charge de travail;</p>   |
| <p>(f) the complexity of the issues,</p>   | <p>f) de la complexité des questions en litige;</p>  |
| <p>(g) the conduct of any party that tended to shorten or to lengthen unnecessarily the duration of the proceeding,</p>  | <p>g) de la conduite d'une partie qui aurait abrégé ou prolongé inutilement la durée de l'instance;</p>                                      |
| <p>(h) the denial or the neglect or refusal of any party to admit anything that should have been admitted,</p>   | <p>h) de la dénégation d'un fait par une partie ou de sa négligence ou de son refus de l'admettre, lorsque ce fait aurait dû être admis;</p> |
| <p>(i) whether any stage in the proceedings was,</p>   | <p>i) de la question de savoir si une étape de l'instance,</p>   |
| <p>(i) improper, vexatious, or unnecessary, or</p>   | <p>(i) était inappropriée, vexatoire ou inutile,</p>   |
| <p>(ii) taken through negligence, mistake or excessive caution,</p>  | <p>(ii) a été accomplie de manière négligente, par erreur ou avec trop de circonspection;</p>  |
| <p>(i.1) whether the expense required to</p>   | <p>i.1) de la question de savoir si les</p>  |

have an expert witness give evidence was justified given

- (i) the nature of the proceeding, its public significance and any need to clarify the law,
- (ii) the number, complexity or technical nature of the issues in dispute, or
- (iii) the amount in dispute; and

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

(3.1) Unless otherwise ordered by the Court, if an appellant makes an offer of settlement and obtains a judgment as favourable as or more favourable than the terms of the offer of settlement, the appellant is entitled to party and party costs to the date of service of the offer and substantial indemnity costs after that date, as determined by the Court, plus reasonable disbursements and applicable taxes.

(3.2) Unless otherwise ordered by the Court, if a respondent makes an offer of settlement and the appellant obtains a judgment as favourable as or less favourable than the terms of the offer of settlement or fails to obtain judgment, the respondent is entitled to party and party costs to the date of service of the offer and substantial indemnity costs after that date, as determined by the Court, plus reasonable disbursements and applicable taxes.

(3.3) Subsections (3.1) and (3.2) do not apply unless the offer of settlement

dépenses engagées pour la déposition d'un témoin expert étaient justifiées compte tenu de l'un ou l'autre des facteurs suivants :

- (i) la nature du litige, son importance pour le public et la nécessité de clarifier le droit,
- (ii) le nombre, la complexité ou la nature des questions en litige,
- (iii) la somme en litige;

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

(3.1) Sauf directive contraire de la Cour, lorsque l'appellant fait une offre de règlement et qu'il obtient un jugement qui est au moins aussi favorable que l'offre de règlement, l'appellant a droit aux dépens entre parties jusqu'à la date de la signification de l'offre et, après cette date, aux dépens indemnitaires substantiels que fixe la Cour, plus les débours raisonnables et les taxes applicables.

(3.2) Sauf directive contraire de la Cour, lorsque l'intimée fait une offre de règlement et que l'appellant obtient un jugement qui n'est pas plus favorable que l'offre de règlement, ou que l'appel est rejeté, l'intimée a droit aux dépens entre parties jusqu'à la date de la signification de l'offre et, après cette date, aux dépens indemnitaires substantiels que fixe la Cour, plus les débours raisonnables et les taxes applicables.

(3.3) Les paragraphes (3.1) et (3.2) ne s'appliquent que si l'offre de règlement :

(a) is in writing;  
(b) is served no earlier than 30 days after the close of pleadings and at least 90 days before the commencement of the hearing;  
(c) is not withdrawn; and  
(d) does not expire earlier than 30 days before the commencement of the hearing.

a) est faite par écrit;  
b) est signifiée au moins trente jours après la clôture de la procédure écrite et au moins quatre-vingt-dix jours avant le début de l'audience;  
c) n'est pas retirée;  
d) n'expire pas moins de trente jours avant le début de l'audience.

(3.4) A party who is relying on subsection (3.1) or (3.2) has the burden of proving that

(3.4) Il incombe à la partie qui invoque le paragraphe (3.1) ou (3.2) de prouver :

(a) there is a relationship between the terms of the offer of settlement and the judgment; and  
(b) the judgment is as favourable as or more favourable than the terms of the offer of settlement, or as favourable or less favourable, as the case may be.

a) qu'il existe un rapport entre la teneur de l'offre de règlement et le jugement;  
b) que le jugement est au moins aussi favorable que l'offre de règlement ou qu'il n'est pas plus favorable que l'offre de règlement, selon le cas.

(3.5) For the purposes of this section, "substantial indemnity costs" means 80% of solicitor and client costs.

(3.5) Pour l'application du présent article, les dépens « indemnitaires substantiels » correspondent à 80 % des dépens établis sur une base procureur-client.

(3.6) In ascertaining whether the judgment granted is as favourable as or more favourable than the offer of settlement for the purposes of applying subsection (3.1) or as favourable as or less favourable than the offer of settlement for the purposes of applying subsection (3.2), the Court shall not have regard to costs awarded in the judgment or that would otherwise be awarded, if an offer of settlement does not provide for the settlement of the issue of costs.

(3.6) Lorsqu'elle détermine que le jugement accordé est au moins aussi favorable que l'offre de règlement visée au paragraphe (3.1) ou qu'il n'est pas plus favorable que l'offre de règlement visée au paragraphe (3.2), la Cour ne tient pas compte des dépens qui sont accordés dans le jugement ou qui seraient par ailleurs accordés, si l'offre de règlement ne prévoit pas le règlement de la question des dépens.

(3.7) For greater certainty, if an offer of settlement that does not provide for the settlement of the issue of costs is accepted, a party to the offer may

(3.7) Il est entendu que si une offre de règlement qui ne prévoit pas le règlement des dépens est acceptée, une partie au règlement peut demander

apply to the Court for an order determining the amount of costs.

à la Cour une ordonnance quant aux dépens.

(3.8) No communication respecting an offer of settlement shall be made to the Court, other than to a judge in a litigation process conference who is not the judge at the hearing, until all of the issues, other than costs, have been determined.

(3.8) Tant qu'une décision n'aura pas été rendue sur toutes les questions en litige, à l'exception de celle relative aux dépens, aucune communication concernant une offre de règlement n'est faite à la Cour, sauf à un juge qui préside une conférence dans le cadre d'une instance et qui n'est pas celui qui présidera l'audition de cet appel.

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

(4) La Cour peut fixer la totalité ou partie des dépens en tenant compte ou non du tarif B de l'annexe II et peut adjuger une somme globale au lieu ou en sus des dépens taxés.

(5) Notwithstanding any other provision in these rules, the Court has the discretionary power,

(5) Nonobstant toute autre disposition des présentes règles, la Cour peut, à sa discrétion :

(a) to award or refuse costs in respect of a particular issue or part of a proceeding,

a) adjuger ou refuser d'adjuger les dépens à l'égard d'une question ou d'une partie de l'instance particulière;

(b) to award a percentage of taxed costs or award taxed costs up to and for a particular stage of a proceeding, or

b) adjuger l'ensemble ou un pourcentage des dépens taxés jusqu'à et y compris une certaine étape de l'instance;

(c) to award all or part of the costs on a solicitor and client basis.

c) adjuger la totalité ou partie des dépens sur une base procureur-client.

(6) The Court may give directions to the taxing officer and, without limiting the generality of the foregoing, the Court in any particular proceeding may give directions,

(6) La Cour peut, dans toute instance, donner des directives à l'officier taxateur, notamment en vue :

(a) respecting increases over the amounts specified for the items in Schedule II, Tariff B,

a) d'accorder des sommes supplémentaires à celles prévues pour les postes mentionnés au tarif B de l'annexe II;

(b) respecting services rendered or disbursements incurred that are not

b) de tenir compte des services rendus ou des débours effectués qui ne sont

included in Schedule II, Tariff B, and

pas inclus dans le tarif B de l'annexe II;

(c) to permit the taxing officer to consider factors other than those specified in section 154 when the costs are taxed.

c) de permettre à l'officier taxateur de prendre en considération, pour la taxation des dépens, des facteurs autres que ceux précisés à l'article 154.

(7) Any party may,

(7) Une partie peut :

(a) within thirty days after the party has knowledge of the judgment, or

a) dans les trente jours suivant la date à laquelle elle a pris connaissance du jugement;

(b) after the Court has reached a conclusion as to the judgment to be pronounced, at the time of the return of the motion for judgment,

b) après que la Cour a décidé du jugement à prononcer, au moment de la présentation de la requête pour jugement,

whether or not the judgment included any direction concerning costs, apply to the Court to request that directions be given to the taxing officer respecting any matter referred to in this section or in sections 148 to 152 or that the Court reconsider its award of costs.

que le jugement règle ou non la question des dépens, demander à la Cour que des directives soient données à l'officier taxateur à l'égard des questions visées au présent article ou aux articles 148 à 152 ou qu'elle reconsidère son adjudication des dépens.

**FEDERAL COURT OF APPEAL**

**NAMES OF COUNSEL AND SOLICITORS OF RECORD**

**DOCKET:** A-113-14

**STYLE OF CAUSE:** HER MAJESTY THE QUEEN v.  
ELEANOR MARTIN

**PLACE OF HEARING:** TORONTO, ONTARIO

**DATE OF HEARING:** DECEMBER 8, 2014

**REASONS FOR JUDGMENT BY:** DAWSON J.A.

**CONCURRED IN BY:** WEBB J.A.  
NEAR J.A.

**DATED:** APRIL 15, 2015

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