Don’t mess with Vavilov: SCC confirms explicit legislative direction required to displace default reasonableness standard

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On June 28, 2024, the Supreme Court of Canada released its decision in *Dow Chemical Canada ULC v. Canada*, 2024 SCC 23, finding that the Tax Court is not a one-size-fits-all solution for tax related disputes—especially if the dispute concerns discretionary ministerial decisions. At issue in *Dow Chemical* was s. 247(10) of the *Income Tax Act* (*ITA*), which provides the Minister of National Revenue discretion to allow or deny a downward adjustment to taxable income. In a 4-3 split, the majority of the Supreme Court held that the appropriate route for challenging a discretionary ministerial decision is an application for judicial review to the Federal Court—the only court with the jurisdiction to apply the appropriate standard of review. In reaching that conclusion, the majority refused to undercut the certainty and predictability offered by *Canada (Minister of Citizenship and Immigration) v. Vavilov*, 2019 SCC 65.

Although directly at issue in *Dow* is the jurisdictional divide between the Tax Court of Canada and the Federal Court, it would be a mistake to ignore the broader implications for administrative law principles. As observed by the majority, the case was pleaded by Dow as a tax case “without due regard to the broader implications in administrative law and without proper consideration for judicial review of ministerial discretion by the Federal Court in other areas.” The majority rejected Dow’s arguments that would have fundamentally altered administrative law principles settled by *Vavilov*.

Background

Section 247 of the *ITA* sets out rules about transactions between a taxpayer and non-arm’s length entities. Section 247(2) provides that the amounts in a transaction will be adjusted to reflect what they would have been if the parties had been dealing at arm’s length. Here, the application of s. 247(2) resulted in a $307 million increase to Dow’s 2006 taxable income. Dow disputed this outcome and made a request under subsection 247(10), which provides discretion to the Minister of National Revenue to make a downward adjustment to taxable income if the circumstances are appropriate “in the opinion of the Minister.” The Minister refused to exercise her discretion in Dow’s favor. Dow then filed an application for judicial review of the Minister’s decision at the Federal

Court. The Minister issued several reassessments, and Dow ultimately appealed the 2017 reassessment to the Tax Court.

The Tax Court and the Federal Court are both statutory courts with limited jurisdiction defined by their enabling statutes. The Tax Court's jurisdiction is limited to reviewing the correctness of assessments, as that appeal right is expressly provided for in section 169 of the *ITA*. On the other hand, the Federal Court has exclusive original jurisdiction over judicial review of federal administrative decisionmakers, unless Parliament has expressly provided for an appeal to another court. Dow's application for judicial review was held in abeyance while the parties asked the Tax Court to consider whether it had the jurisdiction to review the Minister's discretionary decision to refuse the downward adjustment under s. 247(10).

The Tax Court held that the Minister's discretionary decision under s. 247(10) of the *ITA* is integral to the taxpayer's assessment and directly affects its correctness. Therefore, the Tax Court found it had jurisdiction to review the Minister's decision as part of its exclusive appellate function to determine the correctness of assessments. The Tax Court judge proposed that a novel standard of review, distinct from reasonableness, be applied to the Minister's decision – that the discretion had to be exercised "judicially", meaning fairly and honestly and in accordance with sound legal principles, otherwise the discretion had not been exercised at all and the assessment could not be correct in law.

The Federal Court of Appeal disagreed. It found that the Federal Court, not the Tax Court, has exclusive jurisdiction to judicially review discretionary decisions made by the Minister under s. 247(10). The Federal Court of Appeal emphasized that Parliament delegated the exclusive power of judicial review of federal ministerial decisions to the Federal Court, making it the appropriate avenue to challenge the Minister's decision in this case.

Dow appealed to the Supreme Court, arguing that where there is an assessment, challenges to discretionary decisions of the Minister should fall within the Tax Court's jurisdiction because they directly impact the calculation of tax assessed. Dow proposed expanding the Tax Court's powers to include judicial review of the Minister's decision on a reasonableness standard, arguing this would promote access to justice for taxpayers as the Tax Court is a specialized court with an "informal procedure" option.

The issue on appeal was whether a challenge to the Minister's exercise of discretion under s. 247(10) of the *ITA,* where there is an assessment*,* should proceed in the Federal Court as a judicial review of a federal decision-maker, or whether it should proceed in the Tax Court pursuant to that court's statutory jurisdiction over appeals from assessments.

SCC majority decision: Challenges to discretionary decisions are reviewable by the Federal Court

The majority decision, penned by Justice Kasirer (and including Justices Martin, Jamal and O'Bonsawin), held that the Tax Court is not an exclusive forum for tax litigation, and absent an express right of appeal from the Minister's decision to the Tax Court, a

challenge to the decision properly lies with the Federal Court pursuant to its exclusive jurisdiction over judicial review set out in s. 18(1) of the *Federal Courts Act*.

Assessments ≠ discretionary decisions

The majority held that a discretionary decision under s. 247(10) cannot be considered part of an assessment. Tax assessments are non-discretionary because the Minister's role is simply to determine what the law requires a taxpayer to pay by applying a fixed formula. On the other hand, downward transfer pricing adjustments under s. 247(10) of the *ITA* are inherently discretionary decisions made by the Minister. The majority also rejected the idea that the discretion in s. 247(10) must be exercised and therefore forms part of the assessment, as the default rule in s. 247(2) applies unless the Minister chooses to exercise her discretion under s. 247(10). Further, a decision under s. 247(10) is not always accompanied by a reassessment such that they could be considered inextricably linked.

The majority also rejected Dow's argument that the Tax Court's jurisdiction could be expanded to include review of the Minister's s. 247(10) decision by "necessary implication". The *Federal Courts Act* is clear that the Federal Court has exclusive jurisdiction over review of federal administrative decisions unless Parliament **expressly** created a right of appeal to another court, which was not the case here. The term "assessment" should therefore not be expanded to include discretionary decisions.

Vavilov's standard of review principles stand

Justice Kasirer observed that accepting Dow's jurisdictional argument and expanding the meaning of "assessment" would be inconsistent with *Vavilov* and create uncertainty in the law governing standard of review. As emphasized in *Vavilov*, when Parliament chooses to delegate authority, the default position is a reasonableness review. Justice Kasirer noted the contradictory nature of Dow's argument. The Tax Court conducts a non-deferential, *de novo* review of a challenged assessment—the Court is not limited to the evidence before the Minister, and decides whether the assessment was correct, not whether it was reasonable. If discretionary decisions were part of the assessment, they would be reviewed *de novo* for correctness like any other part of an assessment, which would be inappropriate absent legislative direction to that effect.

The majority rejected Dow's argument that the Tax Court could review the Minister's decision on a deferential reasonableness standard alongside its correctness review of an assessment. Dow's argument was, in effect, asking the Supreme Court to grant judicial review jurisdiction to the Tax Court. But only Parliament, not the Supreme Court, could extend such jurisdiction to the Tax Court, which is limited exclusively to the Federal Court by ss. 18 and 18.1 of the *Federal Courts Act*. The Tax Court has no statutory authority to conduct judicial review, nor to grant the remedies available on judicial review. In particular, the Tax Court does not have the authority to quash the Minister's decision if she conducted herself unreasonably in arriving at it.

The majority reiterated that *Vavilov* dictates that the Minister's discretionary decision, conferred to it by statute, is presumptively subject to judicial review on the standard of reasonableness. The availability of a recourse other than judicial review must flow from a clear indication of Parliament's intent to displace the reasonableness standard. *Vavilov* confirmed that the legislature is free to direct another standard of review should

it “intend that a different standard of review apply.” This was not the case here. The majority rejected Dow’s argument that Parliament could be understood to have directed a departure from reasonableness review by providing a statutory appeal of the Minister’s decision as part of an appeal of an assessment to the Tax Court pursuant to section 169 of the ITA. If Parliament had provided a statutory appeal mechanism to review discretionary decisions, *Vavilov* would direct that that the appellate standards of review set out in *Housen v. Nikolaisen*, 2002 SCC 33, should ordinarily apply. Yet this was inconsistent with statutory appeals of assessments to the Tax Court, which are conducted *de novo*—a less deferential standard than typical statutory appeals.

Overall, Dow’s argument that the appeal mechanism at issue provides at once for *de novo* correctness review of some parts of the assessment and for reasonableness review of a discretionary decision on the basis that it is inextricably linked to that same assessment cannot be reconciled with the administrative principles in *Vavilov*.

The majority also rejected the Tax Court’s judge’s novel standard of review by which the Minister would form her opinion “judicially” or “properly”, and if not, it could be corrected by the Tax Court. This was an error of law, as the Minister’s discretionary decision is an administrative decision, not a judicial one, and that is not how an administrative decision is reviewed under the *Vavilov* framework. The majority held that this was not an appropriate appeal in which to create a novel standard of review, and that applying anything but a reasonableness standard to the Minister’s discretionary decision under. S. 247(10) of the *ITA* would undermine the certainty created by *Vavilov*.

SCC dissenting reasons

The dissenting justices (Karakatsanis, Côté and Rowe JJ.), in reasons authored by Justice Côté, concluded that judicial review should not be used as a tool to circumvent the system of tax assessments and appeals established by Parliament. In their view, because the Minister’s decision to deny a downward transfer pricing adjustment goes directly to the correctness of a taxpayer’s assessment, it is within the scope of the Tax Court’s jurisdiction as it is inextricably linked to the assessment and directly impacts the ultimate amount of tax owing. For this reason, the Minister’s decision could be properly reviewed by the Tax Court as part of the scope of an appeal of the assessment.

Justice Côté found that contrary to other provisions of the *ITA* that confer a discretion on the Minister affecting the amount of a taxpayer’s income, s. 247(10) is not permissive—the discretion must be exercised in order for tax liability to be calculated correctly. She noted that if the Minister’s discretion is not exercised properly, the resulting assessment cannot be correct, and therefore it is inextricably linked to the correctness of the assessment. She therefore distinguished s. 247(10) from other permissive exercises of Ministerial discretion, limiting her findings to s. 247(10).

On the question of the applicable standard of review, Justice Côté noted that although the Tax Court conducts a *de novo* review of an assessment on a correctness standard, a deferential standard of review nevertheless applies when the Tax Court is dealing with the Minister’s discretionary decision under s. 247(10) because the court cannot substitute its opinion for that of the Minister or prevent her from arriving at the same decision upon reconsideration. When dealing with a challenge to the Minister’s exercise of discretion under s. 247(10) as part of an appeal of an assessment, the Tax Court must decide whether to refer the matter back to the Minister for reconsideration and

reassessment. In Justice Côté's view, this approach still shows an appropriate amount of deference to the Minister's exercise of discretion and does not undermine the principles in *Vavilov* because the Minister would be free to arrive at the same decision on reconsideration.

Key takeaways

- The standard of review principles established in *Vavilov* remain the guiding principles and give effect to the legislature's design choices in crafting statutory appeal mechanisms.
- To discern Parliament's intention regarding the applicable standard of review, we must look at the nature of the statutory mechanism by which a decision is challenged. *Vavilov* demands that courts defer to statutory decision-makers by presumptively applying reasonableness review.
- Clear and express direction in the legislation is required to displace the default reasonableness standard of review for review of administrative decisions. Absent such legislative direction, it would be inappropriate for the court to displace the presumptive reasonableness standard.
- Challenges to discretionary decisions under section 247(10) of the *ITA* are to be brought as applications for judicial review in the Federal Court on a reasonableness standard. This aligns with Parliament's legislative design and ensures proper administrative law remedies are available.
- Any changes to jurisdictional boundaries between the Tax Court and the Federal Court or to the remedies available to each court should be left to Parliament.

For a closer look at the tax implications of this decision and the companion decision in *Iris Technologies Inc. v. Canada*, 2024 SCC 24, please read the bulletin prepared by our Tax Disputes colleagues, Laura Jochimski and Laurie Goldbach, available here.

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