DEALING WITH TAX OFFICIALS: SELECTED ISSUES IN ADMINISTRATION, ENFORCEMENT AND APPEALS

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MAY 2010

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These materials outline issues with which a professional becomes involved in practice. The issues pertain to the administration and enforcement of the *Income Tax Act* (the "*Act"*) and objections/appeals relating to actions taken by the Canada Revenue Agency (in this paper may also be referred to as "CRA" or the "Agency"). Generally, the paper deals with two parts of the *Act*:

- Sections 150 to 166.2; and
- Sections 222 to 227.1.

This paper contains a practical guide for handling certain issues that arise under these sections. I will first set out the relevant statutory scheme under the *Act* in a number of areas. I will then highlight the issues which arise and then will provide some practical tips in these areas. I have made no attempt to provide a thorough review of the sections or of the case law in these areas.

Overall, the structure of the *Act* mirrors the process that many taxpayers experience. My comments will follow the *Act* and that process. Specifically, the paper addresses issues in certain areas:

- Returns, Elections and Designations;
- Assessments and Notices of Assessments;
- Limitation Periods for Assessments;
- Dealing with the Canada Revenue Agency;
- Canada Revenue Agency Powers & Limitations on Disclosure;
- Notices of Objections; and
- Collections.

PART I - RETURNS, ELECTIONS AND DESIGNATIONS

1. Tax Returns

1.1 Relevance of Returns

A tax lawyer does not usually prepare tax returns. Yet a tax lawyer must be familiar with the manner in which the return is laid out, its required contents and the deadlines by which such returns must be filed. Tax disputes generally revolve around the contents of a taxpayer's return

and penalties may be assessed for late or negligent filings. Tax evasion charges may flow from omissions or misstatements on a return. Therefore, as an advocate for the taxpayer, a tax lawyer must be able to provide a taxpayer with advice to avoid such pitfalls. Most of the substantive rules in the *Act* are directed at what will ultimately be put in a tax return. Therefore, a professional who plans a transaction should consider the question: "How will this transaction be reported in the relevant returns?" In addition, in a tax litigation matter, one should always obtain and review a copy of the return because the dispute usually concerns the position taken by the taxpayer in that return. It is difficult to adequately represent a taxpayer without knowing precisely the position taken in the return.

Although commonly referred to as a "tax return", the *Act* actually refers to a "return of income". The obligation to file a "return of income" is contained in subsection 150(1). A return of income must be filed with the Minister "in prescribed form containing prescribed information". The prescribed forms and deadlines are as follows:

Individual	T1	April 30 of the next year
Deceased Individual	T1	If death occurs after October in the year or before May of the next, then extended to 6 months from date of death
Corporation	T2	6 months after year-end
Trust	T3	90 days after year-end

1.2 Some Legal Issues In Filing Returns

In a self-assessing system, the taxpayer initiates the process by calculating his or her liability in anticipation of filing a return. In so far as taxpayers wish to avoid late filing penalties, they may hastily complete a "return" with inadequate information. Will they then avoid penalties?

Frequently, a tax lawyer is asked to consider the disclosure requirements for a return. Yet, the *Act* is silent on this issue. Generally, taxpayers should err on the side of "more disclosure". Full disclosure of all details will foreclose an argument by Canada Revenue Agency that the taxpayer made a misrepresentation in the return and thus Canada Revenue Agency is not bound by the normal reassessment period. Penalties for gross negligence under subsection 163(2) may also be avoided.

1.2.1 Penalties - Late Filing

There have only been limited occasions where the Courts have commented on what constitutes a "return". For example, in *Carlson v. The Queen* 73 D.T.C. 5192 (F.C.T.D.), the taxpayer filed returns marked "temporary returns". These returns did not contain all the prescribed information regarding the income of the taxpayer. The taxpayer objected to the late filing penalties assessed by CRA. The Federal Court held that the "temporary returns" were not "returns" within the meaning of the *Act* as they did not contain all of the prescribed information. In other words, the taxpayer had not fulfilled his obligation under subsection 150(1). Taxpayers may also allege that

they have filed a return and CRA takes a contrary position. The taxpayer was successful in its claim to avoid penalties. See *Skyway Developments Ltd.* 2007 D.T.C. 1698 (T.C.C.).

1.2.2 Failure to File a Return

In *The Queen v. Hart Electronics Ltd.* 59 D.T.C. 1192 (Man. C.A.), the Crown attempted to prosecute the taxpayer for failing to file a return when the return filed had not been signed. The Court concluded that an unsigned return was a "return" for the purpose of the *Act* because the unsigned return did contain the information prescribed under the *Act*. See *HMTQ v. Watson* (July 19, 2005 – B.C.S.C.) where a one-page letter was held not to be a return and the taxpayer was convicted for failure to file. The case also refers to related jurisprudence.

1.2.3 Amending a Return

May a taxpayer amend a return? The *Act* does not contain a general provision which requires Canada Revenue Agency to accept an amended return. In limited circumstances, subsection 152(6) (carryback of a loss, etc.) may permit this. Refilings are required in other circumstances involving the application of the replacement property rules (section 44) or the failure to repay a shareholder loan within the requisite period (subsection 15(2)). For a discussion, see *Lussier v. The Queen* 2000 D.T.C. 1677 (T.C.C.)

The *Act* also contains many permissive deductions such as capital cost allowance. Several provisions in the *Act* permit a taxpayer to amend the return for a particular taxation year. However, no general provision gives the taxpayer a right to amend a return in all circumstances. The Federal Court of Appeal in *The Queen v. Godfrey G.S. Moulds* 78 D.T.C. 6068 at 6073 indicated that:

> "The principle invoked by Counsel for the Appellant that "a person may not appropriate and reprobate" has no application in this case because the Respondent never had the right to elect between two inconsistent courses of action. His only choice was to claim or not claim a capital cost allowance; once he had decided to claim it, he had to calculate its amount in the manner prescribed by the Statute."

Although Canada Revenue Agency permits an amendment to a return in certain circumstances (Information Circular 84-1) there is no obligation on the Agency in the absence of a statutory provision to accept an amendment to a return. This is based on the decision of the Supreme Court of Canada in *Montreal Trust Co. (Lodestar Drilling Co. Ltd.) v. MNR* 62 D.T.C. 1242 (S.C.C.) and of the Exchequer Court in *Gerald J. Ryan v. MNR* 67 D.T.C. 5325 at 5333. This conclusion was also reached by the Tax Court of Canada in *James Stephenson v. MNR* 86 D.T.C. 1520 (T.C.C.). In that case, the taxpayer availed himself of the forward averaging election contained in subsection 110.4(1). The taxpayer subsequently discovered that he had inadvertently failed to claim certain expenses which lowered his income. Canada Revenue Agency reassessed for many of those expenses but would not reassess permitting a new forward averaging election. The Court upheld the Crown's position in denying the new election. At page 1526, the Court stated:

> "When assessing a taxpayer the Minister considers the information in the taxpayer's return of income, and if he has good reason disallows certain deductions claimed by the taxpayer. The Minister however has no authority to arbitrarily vary an election made by a taxpayer, even if his assessment cries out for revision.
>
> Adverse tax consequences may flow to taxpayers who, like the appellant, file their income tax returns in good faith but because of facts not known to them at the time the returns were filed are assessed tax differently from which they anticipated when they filed their returns and elections under subsection 110.4(1). The inability to amend the election and the return of income in such circumstances is a serious gap in the tax system."

The inability of the Minister to amend returns in statute-barred years when appropriate was also discussed in *The Queen v. Canadian Marconi Company* 91 D.T.C. 5626 (F.C.A.).

1.2.4 Penalties for Gross Negligence and Failure to Report Income

Subsection 163(1) imposes a penalty if a taxpayer fails to report income for two years within a four year period. Subsection 163(2) imposes penalties if a taxpayer knowingly or with gross negligence makes a false statement or omission. In either case the burden of proof is on the Crown (subsection 163(3)). A due diligence defence may be available (*Dunlop* 2009 TCC 177, quoting *Saunders* (TCC). See also *Saunders* 2010 (TCC) regarding a section 162(1) penalty). Penalty Reports are prepared by the Auditor and review criteria such as materiality, knowledge of the taxpayer, history of compliance and involvement of the taxpayer (including signature) in the preparation of the return. As to what constitutes "gross negligence", see Part III of the paper below. See *Blackwell and Jenkinson v. The Queen* 2007 TCC 695 which shows the interaction between the Minister's ability to reassess such penalties and to reassess beyond the "normal reassessment period". See also *Besner v. The Queen* (July 3, 2008) (TCC) regarding the interaction between the assessment of penalties and prosecution for tax evasion. Subsection 239(3) indicates there is no liability for such penalties if a person in convicted of tax evasion unless the penalties were assessed before the information or complaint giving rise to conviction was laid or made.

The CRA has also been applying penalties for failure to file information slips (e.g. T1135). There is also mixed success for non-resident corporate taxpayers regarding the penalty in subsection 162(2.1). (*Exida.com* 2009 TCC 373 and *Goar Allison & Associates* 2009 TCC 174.)

1.2.5 Discovering Errors – What are the Options?

Sometimes errors are discovered in returns. Yet must the taxpayer (or advisor) inform Canada Revenue Agency? Certainly, a taxpayer will want to inform Canada Revenue Agency where a reduction in the amount outstanding or an increased refund will be the result. Generally, Canada Revenue Agency will accept amendments to returns as long as they are not discretionary deductions that should have been taken at the time of filing. IC 84-1 sets out the circumstances in which Canada Revenue Agency will accept an increase in permissive deductions.

(a) No Duty to Amend Return

Generally speaking, there is no obligation to inform Canada Revenue Agency where the error will disadvantage the taxpayer as long the error was honestly made. A recent technical interpretation (2005-01132417) concluded that a taxpayer had no duty to advise the CRA of a mistake made in a return if it was not aware of the error at the time of filing. The question was posed by a Tax Services Office (TSO) on a review of a taxpayer's file: could a taxpayer's tax return that was otherwise statute-barred be reassessed on the basis that the taxpayer had made a misrepresentation under paragraph 152(4)(a) by not filing an amended return when it became aware of an error after the original filing? The document says that generally there is no obligation to inform the CRA of a mistake in these circumstances and no right to reassess after the normal limitation period.

The technical interpretation notes the taxpayer's reliance on an analogous situation in *Regina Shoppers Mall* 91 D.T.C. 5101. In that case, the taxpayer sold real estate in 1976 and treated the proceeds as a capital receipt; the CRA reassessed as income, but the taxpayer filed for subsequent years as if the amount were a capital receipt until the Federal Court of Appeal sided with the CRA in 1989. The CRA then reassessed the statute-barred 1979 and 1980 taxation years, arguing that the taxpayer should have filed its return consistently with the CRA position or should have filed a waiver of the four-year limitation period. The F.C.A. said that the taxpayer was within its rights to file as it did for subsequent years while its original appeal for 1976 remained outstanding. The CRA could not reassess the statute-barred years. The F.C.T.D. said that "it is not the duty of the reporting taxpayer to alert the Department to a situation as to which any reasonable person would believe the latter is fully aware." The F.C.A. approved these comments. The technical interpretation distinguished a T.C.C. decision cited by the TSO in which "the prior audit had been finalized and it did not involve a dispute over whether a specific provision of the Act had application. [It] involved the taxpayer's bookkeeping system. Furthermore, the misrepresentation was made at the time the [taxpayer] filed its tax returns."

On the basis of its review of the jurisprudence referred to, the CRA said that it was quite clear that for an assessment under subparagraph 152(4)(a)(i) to be valid, <u>any misrepresentation must be made at the time that the return is filed</u>. Thus, the taxpayer's failure to file amended returns does not, by itself, constitute misrepresentation and the taxpayer's statue-barred return cannot be reassessed. The TSO acknowledged that the taxpayer did not make any misrepresentation when it filed its 2000 tax return.

(b) Wait or Voluntary Disclosure?

The taxpayer has two choices: Sit back and wait for the reassessment period to expire and, in the interim, hope that the error is not discovered or approach Canada Revenue Agency to make a voluntary disclosure to avoid penalties and prosecution as described in Information Circular 00-1R2 dated October 22, 2007. The choice will depend upon whether the error could be construed as tax evasion. The tax advisor must consider whether the first choice is possible if it could be argued that the taxpayer made a misrepresentation in the return caused by neglect and thus the reassessment period will never expire.

To qualify a voluntary disclosure as valid, the following conditions must be met:

- voluntary
- complete
- penalty involved
- includes information that is at least one year past due* or;
- is to correct an omission or error to a current return that has already been filed.

The disclosure will not apply for:

- late filed elections
- credit/refund requests
- adjustment requests where no penalty is applicable

Under paragraph 32 of the Circular, a disclosure will not be considered "voluntary" in two situations: (1) the taxpayer was aware of, or had knowledge of, an audit, investigation, or other enforcement action set to be conducted by the CRA or any other authority or administration with respect to the information being disclosed to the CRA; or (2) enforcement action relating to the disclosure was initiated by the CRA or any other authority or administration against the taxpayer or against a person associated with or related to the taxpayer (including, but not limited to, corporations, shareholders, spouses, and partners), or against a third party where the purpose and impact of the enforcement action against the third party is sufficiently related to the particular disclosure. In addition, the disclosure will not be considered voluntary if the enforcement action is likely to have uncovered the information that is being disclosed.

The Voluntary Disclosure programme is now again being administered by the Compliance Programs Branch (Assistant Director, Enforcement Division) and not by the Appeals Division. A disclosure may be made on a named or no-name basis. Under the first method, the taxpayer is described in the initial submission (RC 199) – "Taxpayer Agreement". The form is to be sent to the Tax Services Office where the taxpayer is resident. The methodology for "no names" disclosure is described in the revised Information Circular (paragraph 44). For further information also see Auditor General Report, Chapter 6 on Voluntary Disclosures (November, 2004). Not all attempted voluntary disclosures will quality (*L'Heureux* 2006 D.T.C. 6697).

A number of cases have been decided recently regarding voluntary disclosure. The issue generally involves a judicial review of the Minister's decision not to accept a voluntary disclosure (*Wong v. MNR* 2007 FC 628, *Karia v. MNR* 2005 F.C., *Les Peintres Filmes Inc.* 2007 F.C., *L'Heureux v. A.G. of Canada* 2006 F.C., and *Brown v. CCRA* 2005 F.C.). Bruce Russell wrote the following summary of this jurisprudence in *Tax Hyperion* (Vol. 4, No. 11):

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* or less than one year past due where the disclosure is to correct a previously filed return or where the disclosure contains information that also meets the condition of the first requirement.

So what can we learn from these cases?

Where a CRA official indicates acceptance of a client into the VDP for a particular period, (either explicitly or implicitly) the subsequent disclosure should be allowed regardless if it is later discovered that the client did not meet the initial requirements for the program. The *Wong* and *Karia* cases espouse the issue of *promissory estoppel* on the Crown and that a taxpayer cannot be put at risk due to the Crown's change of heart.

It is just as important to ensure that disclosures are complete and are not undertaken where there is any related CRA enforcement action. Where a voluntary disclosure is unsuccessful for these reasons (as in *Peintres Filmar*, *L'Heureux* and *Brown*), the person may be assessed for the full amount of tax owing, subject to all applicable penalties and interest.

It should be noted that the outcome of these cases is not just relevant for purposes of GST/HST disclosures. The VDP provides relief from penalty and interest for assessments under various Acts administered by the CRA.

See *Crocionne* 2008 DTC 6463 (F.C.C.) in which the taxpayer's judicial review was unsuccessful. If the mistake relates to a current balance such as the UCC of depreciable property, then the taxpayer should file an amended return. As the UCC balance is newly calculated every year, the taxpayer must correct the error upon filing the next return. Otherwise, a misrepresentation from neglect or wilful default could be the result in the next year.

A taxpayer who applies for but is denied access to the voluntary disclosure programme can still claim solicitor-client privilege. *1496956 Ontario Inc.* (2009 Can LII 12328). Cf. *Visser* 89 DTC 5172 (PEI SC).

(c) Rectification

Some taxpayers have used the concept of rectification to correct errors. Courts of equity rectify instruments which are in error. Recent decisions involving correction by the courts include: *Columbia North Realty* 2005 NSSC 212; *Juliar* 2000 D.T.C. 6589 (Ont. C.A.); *Snow White Productions* [2004] 3 C.T.C. 282 (B.C.S.C.); *CI Fees Trust* [2004] O.J. No. 4789 (S.C.); *Prospera Credit Union* 2002 BCSC 1806; *Razzaq Holdings* 2000 BCSC 1829. *QL Hotel Service Limited v. Ontario (Minister of Finance)* [2008] O.J. No. 1365 (S.C.); *Binder and Binder v. Saffron Rouge et al.* 2008 DTC 6112; *Winclare Management* (09-CV-00370756, OCJ), *Felix & Norton* 2009 QCCS 919; and *Re Aboriginal Diamonds Group Ltd.* [2007] N.W.T.J. No. 41 (S.C.). The following is a summary of the Crown's position regarding rectification which was announced in 2005 at the Tax Subsection of the C.B.A. (B.C. Branch):

- A letter should be sent to the Director of the Tax Services Office advising rectification will be sought and asking to have the Notice of Objection, if there is

one, held in abeyance. If there is no Notice of Objection, the taxpayer should consider filing one.

- The CRA officer handling this objection, if there is one, should be informed that restitution will be sought.

- CRA should be named as a party in the motion.

- The Department of Justice ("D of J") on behalf of CRA should be served with the Notice of Motion.

- D of J should be advised with whom at CRA the taxpayer has been dealing.

- The D of J on behalf of CRA should be provided with the affidavits and materials upon which the Applicant is relying for the motion respecting the alleged error and the original intent of the parties.

- The D of J on behalf of CRA should be advised of the legal and factual basis for the motion. The Crown may ask for more evidence to show the original intention of the parties.

- If other parties will be affected by the motion and potential change of legal documents or relationships, the Crown will want to know if these third parties are aware of the motion, aware of any effect it will have on their legal rights and whether they oppose the motion.

- The D of J has a monthly rectification teleconference call in which the pending rectification motions are discussed. The Crown will ask that the taxpayer delay the motion until the Crown has had a chance to discuss it with the committee and give advice to CRA. The Crown may seek more information from the Applicant after the first teleconference call which the Crown will need to discuss with the committee the next month.

- CRA's position is that, without a formal court ordered rectification after the fact, changes to legal documents will not be accepted for tax purposes: *Sussex Square Apartments Limited v. The Queen*, 99 D.T.C. 4431 [Bowman, J.].

- The Crown will inform the taxpayer if CRA intends to oppose the motion.

For a fuller discussion see the papers in the 2005 Annual Conference Report of the Canadian Tax Foundation by Ewens and Lynch and the article by Gill in the bibliography.

1.2.6 Civil Penalties

On June 29, 2000 section 163.2 of the *Act* and section 285.1 of the *Excise Tax Act* became law. Both these provisions impose civil liability on parties other than the taxpayer who engage in certain conduct involving the making of false statements. There has been considerable concern

in the professional community regarding the possible application of these penalties in circumstances that might be unwarranted.

The Agency consulted with a variety of organizations and individuals with a view to creating guidelines for the possible assessment of these new third party civil penalties. On December 18, 2001 Information Circular 01-1 entitled *Third Party Civil Penalties* was released. This bulletin addresses a number of issues including principles of application, a synopsis of the law, and interpretation of various provisions within the law. Moreover, the circular contains 17 examples of circumstances in which the penalties may or may not be applied.

Paragraph 67 of the Information Circular is quite interesting and seems to confirm comments made earlier in this paper:

> "If an advisor or tax return preparer finds himself or herself in a situation where he or she discovers that another person had made a false statement for tax purposes (e.g. he or she obtains a new client and finds that the previous accountant has made a false statement), the new advisor or tax return preparer would be expected to rectify the situation to the extent that the false statement affects the tax return of the current year. The advisor or preparer should advise his or her client to make a voluntary disclosure as described in Information Circular (IC) 00-1, *Voluntary Disclosures Program*, for the prior years or file amended returns for each of the affected years. If the client does not follow this advice, the advisor or preparer is not exposed to the third-party civil penalties in respect of prior years. If the current-year return does not reflect the corrections because the taxpayer did not agree to it, and the advisor or preparer prepared the return knowing of the discrepancy, the advisor or preparer as well as the taxpayer may be subject to penalties. The advisor would be subject to the third-party civil penalties and the taxpayer to a gross negligence penalty (subsection 163(2) of the *Act* and section 285 of the ETA)."

In 2007, CRA advised that it has levied a civil penalty under subsection 163.2(4) in three circumstances and that other situations are under review. A News Release issued on March 16, 2010, entitled "Minister Ashfield assures Canadians that shady tax preparers and promoters will be penalized", provides some answers.

According to the News Release, there are almost 100 third-party penalty audits which are in progress or have been completed. Nineteen tax preparers have been assessed almost $1.7 million in third-party penalties, and there are audits of 15 tax preparers underway. Currently there are 71 audits involving promoters. Recent examples of third-party penalties include a penalty of $1.8 million levied against a "promoter" of a "scheme involving RRSPs" and two penalties of $24 million proposed against promoters of a "tax gift giving arrangement". Further, as a consequence of audits involving "tax shelter gifting arrangement schemes", the CRA has revoked the registration of 33 participating charities. Further, some of the civil penalty audits have been the genesis of criminal prosecutions.

2. Elections

For further discussion, see the article by Norm Tobias in the 1996 CTF Annual Conference Report.

2.1 Late, Amended or Revoked Elections

The *Act* contains rules for making certain elections. The courts have held that an election cannot be amended, revoked or made late in the absence of a statutory provision to the contrary. For example, the filing of late section 85 elections was not permitted in *Deconinck v. The Queen* 88 D.T.C. 6410 (T.C.C.). In *Muzich Family Trust v. MNR* 93 D.T.C. 314 (T.C.C.), the trust was 9 days late in filing its preferred beneficiary election. The Court agreed with Canada Revenue Agency that the words in section 104 of the *Act* mandated that this election be filed on time and the trust's appeal was dismissed. The *Muzich* decision may be contrasted with the decisions in *Fisher v. MNR* 88 D.T.C. 1027 (T.C.C.) and *Trynor v. MNR* 88 D.T.C. 1294 (T.C.C.). In those cases, the taxpayers owned property on V-Day. Under *ITAR* 26(7), an election to designate the cost of the property had to be filed not later than the day on or before which a return of income was required after 1971. The case turned on the issue of the extent to which section 150 of the *Act* was incorporated into the *ITAR*. The taxpayers had no tax payable until they sold the property and as a result did not file returns. The Court held that they were entitled to file the election for the year of sale. In *Calinisan* 2005 D.T.C. 375, the Tax Court denied the taxpayer the benefit of the election to defer stock option benefits because the election under subsection 7(8) of the Act had not been filed on a timely basis. See also *Holder* 2004 D.T.C. 6413 (F.C.A.) regarding the election to trigger capital gains in subsection 110.6(19).

Where the *Act* does provide for amendment, revocation or late filing it usually requires that a penalty be paid. As a result of the introduction of the "Fairness Package/Taxpayer Relief Provisions" (discussed below), certain elections may be late filed under subsection 220(3.2)(a) and Regulation 600. Yet, for the prospect of success, see *Johnston Family 1991 Trust v. MNR* 99 D.T.C. 5508 (F.C.T.D.)

2.2 Timing Issues

Tax practitioners must be sensitive to timing issues relating to filings. For example, a section 85 election must be filed at the earlier of the time that either the transferor or the transferee must file a tax return for the year in which the transfer occurred. One must therefore determine the taxation year of both parties. Capital dividend account elections (Subsection 83(2)) must be filed on or before the earlier of the day the dividend is paid or payable.

2.3 Form of the Election

Most elections must be made in prescribed form. Where no form is prescribed, taxpayers can elect by writing a letter to the Canada Revenue Agency. Canada Revenue Agency has indicated at times that it will not accept notations on a schedule reflecting the results of an election. The legal correctness of this position is doubtful. If a taxpayer does write such a letter, the taxpayer must track the words of the *Act* so that it is clear what election is being made. A reference to a section number is helpful. If a form has been prescribed, make sure the most current revision of

the form is used because some election forms are updated annually. Canada Revenue Agency has been known to reject completed election forms because the form was revised.

In some cases (such as subsection 83(2) for capital dividend account dividends) the election must also be made in "prescribed manner". A "prescribed manner" often relates to the number of copies or who may sign the election form. Often the *Act* requires that the election be filed with or separate from the return of income.

3. Designations

3.1 Election or Designation?

The *Act* also contains a number of designations and the *Act* distinguishes between an election and a designation. For example, a taxpayer may designate a "safe income" dividend under subsection 55(5). Paragraph 220(3.2)(a) of the *Act* only permits late filings with respect to prescribed "elections". Yet the *Act* also contains subsection 220(3.21) which prescribes the new debt forgiveness designations as "elections" for the purpose of subsection (3.2).

3.2 Late Filing of Designations

In *Trico Industries Ltd. v. The Queen* 94 D.T.C. 1740 (T.C.C.) the taxpayer was unsuccessful in having the Court permit it to make a late-filed designation under paragraph 55(5)(f). The Court held that the plain meaning of that provision did not permit a late-filed designation. The Court did state that following *Lee v. MNR* 90 D.T.C. 1738 (T.C.C.) relief is available if the taxpayer established that an honest mistake had occurred. The taxpayer in *Trico* could not meet this burden. In *Nassau Walnut Investments Inc. v. The Queen* 95 D.T.C. 267, the Tax Court did permit a late-filed paragraph 55(5)(f) designation. The Federal Court of Appeal upheld this finding (96 D.T.C. 5051). See also *Lussier v. The Queen* 2000 D.T.C. 1677 (T.C.C.).

The Crown was successful in its appeal of a late-filed designation in *The Queen v. United Equities Limited* 95 D.T.C. 5042 (F.C.A.). That case involved late-filed scientific research tax credit designations. The SRTC provisions permitted a late-filed designation in certain circumstances. The Federal Court of Appeal held that the taxpayer could not late-file its SRTC designation because it had not fulfilled one of the prerequisites (the timely filing of an information return).

PART II - ASSESSMENTS AND NOTICES OF ASSESSMENTS

1. Due Dispatch

Once a return is filed with supporting schedules, elections and designations, Canada Revenue Agency has an obligation to assess with "all due dispatch" and to issue a notice of assessment. This is an annual event which the Minister must undertake with respect to each return filed. In *Jolicoeur v. M.N.R.* 60 D.T.C. 1254 (Ex. Ct.) Fournier J. provided the following explanation of the expression at p.1260:

> "In my opinion, the words with all dispatch have the same meaning as 'with all due diligence' or 'within a reasonable time' ... in the

> legal sense, they are interpreted as giving a discretion and freedom, justified by circumstances and reasons, to the person whose duty is to act. The acts involved are not submitted to a strict and general rule ...
>
> There is no doubt that the Minister was bound by time limits when they are imposed by the statute, but, in my view, the words 'with all due dispatch' are not to be interpreted as meaning a fixed period of time. The 'within all due dispatch' time limit purports a discretion of the Minister to be exercised, for the good of the administration of the *Act*, with reason, justice and legal principles."

In *Rosales v. The Queen* [1993] 2 C.T.C. 2852 (T.C.C.), the Tax Court held that two years for assessment was not unreasonable in the context of a large deduction for a business investment loss. In *Rosales*, the Court noted that the taxpayer's return was the subject of substantial communication between the Crown and the taxpayer in the period after the return had been filed and prior to the mailing of the notice of assessment. Yet in *Ginsberg v. The Queen* 94 D.T.C. 1430 (T.C.C.), the Court ordered that an assessment be vacated because it took the Crown 18 months to assess the return. The decision contains a lengthy discussion of the process involved in assessing a return. The critical piece of evidence was the admission by the Canada Revenue Agency official that there was nothing extraordinary in the return and that he could not explain why it took 18 months for the return to be assessed. Once again, the *Jolicoeur* decision was mentioned for an interpretation of the words "all due dispatch". At page 1437, Mr. Justice Christie stated:

> "I believe that if there is a delay that *prima facie* indicates a failure to examine and assess a return with all due dispatch as required under subsection 152(1) of the *Act* there is an onus on the respondent to establish by evidence pertaining to the manner in which that return was dealt with that the delay was not unreasonable. It is insufficient to simply argue that the return must be regarded as falling within the small number of unidentified returns that, because of the very large volume of returns dealt with at a particular taxation centre, will inevitably be the subject of inexplicable and protracted delays."

Unfortunately, the Federal Court of Appeal overturned this decision (96 D.T.C. 6372). See also *Carter v. The Queen* 2001 D.T.C. 5560 (F.C.A.).

2. Assessment - Legal Effect?

2.1 What is an Assessment?

One of the earliest yet still accurate descriptions of an assessment is contained in the decision of *Pure Spring Company Limited v. MNR* (1946) 2 D.T.C. 844 (Ex. Ct.). At page 856, Mr. Justice Thorson described the assessment process as follows:

> "The items of income and deductions in the taxpayer's return must be checked and verified where necessary. In respect to the amounts claimed as deductions the Minister may have to decide whether they are permitted by the *Act*. Such decisions involve no exercise of discretion but are either administrative applications of the law to the claims made, or they may involve, as in the case of the disallowances of the directors' fees in the present case, findings of fact to which the law is then applied, in which the function is really a judicial one which the Minister must perform with a "judicial temper". The Minister may require further information from the taxpayer under several sections. He may have to decide whether a refund should be made under 53. There are many other things that may have to be done before there can be an assessment and many tasks may be involved in such various tasks. Then when all the items have been settled there must be computation of the amount of profit again to be assessed less the allowable deductions before the total amount of tax liability can be ascertained and fixed. ..."

This position was recently confirmed by the Federal Court of Appeal in *The Queen v. Loewen* 2004 D.T.C. 6321 (FCA). An assessment is the product of an administrative process that fixes the amount of a taxpayer's liability. The case law indicates that neither the reasons for it nor the materials on which it is based constitute part of an assessment (*Consumers' Gas Company* 87 D.T.C. 5008 (F.C.A.)). The Minister also has wide latitude in deciding how to ascertain or fix the liability of the taxpayer (*Provincial Paper Ltd.* 54 D.T.C. 1199 (Ex. Ct.)).

2.2 Assessment vs. Notice of Assessment

On page 857 of the *Pure Spring* decision, Mr. Justice Thorson described the assessment process as "solely administrative" and then differentiated between the assessment and the notice of assessment as follows:

> "The assessment is different from the Notice of Assessment; the one is an operation, the other a piece of paper."

The Canadian tax courts have continued to maintain that this is the nature of an assessment and a notice of assessment. The nature of an "assessment" was also described in the decision of *The Dominion of Canada General Insurance Company v. The Queen* 84 D.T.C. 6197 (F.C.T.D.). At page 6202 Mr. Justice McNair stated as follows:

> "An assessment is an administrative process within the exclusive function of the Minister culminating in the ascertainment and fixation of tax liability in accordance with the requirements of the statute. The Minister is not necessarily bound by the taxpayer's return but he may quite properly accept it as correct and fix the tax liability accordingly. The assessment and the Notice of Assessment are different things; the one is in operation, the other a

> piece of paper. But the two are inextricably bound together and the assessment itself cannot be regarded as complete until the Notice of Assessment has been effectively given."

Thurlow, J. neatly summarized the assessment procedure in *Scott v. MNR* 60 D.T.C. 1273 at page 1277:

> "These provisions prescribe the procedure by which the amount of the taxation imposed by the statute on each taxpayer is to be ascertained and settled. In the first instance, the taxpayer is required to furnish the relevant information and to estimate the tax. The Minister is then charged with the duty of examining the taxpayer's return of income and of assessing the tax. In so doing he obviously may agree or disagree with the taxpayer's estimate of the tax, but whether he agrees or not, he is required to send the taxpayer a Notice of Assessment. The taxpayer then has the right to object to the assessment and subsequently to appeal therefrom.
>
> The liability to pay tax must be distinguished from the mechanical operation of assessment and the determination of calculation of tax liability. Assessment is the procedural means for achieving the tax result. The question of tax liability or not in any taxation year is dependent upon the law as it applied in that year. Liability for tax is not affected by an incorrect or incomplete assessment or by the fact that no assessment has been made (Section 46(3)). If a taxpayer wants to object to the validity of an assessment in determining his tax liability then he must take the appropriate appeal steps within the prescribed time periods. Failing that, an assessment is deemed valid and binding."

This view of an assessment and the notice of assessment remains the same under the *Act*. For example, *Dauphinais v. The Queen* 94 D.T.C. 1153 (T.C.C.) describes the principles distinguishing an assessment and a notice of assessment. In *Aztec Industries Inc. v. The Queen* 96 D.T.C. 6044, the Federal Court of Appeal stated that an assessment is not complete until the notice of assessment has been sent to the taxpayer. The taxpayer in *Aztec* successfully argued for an extension of time to file a Notice of Objection (discussed elsewhere) on the basis that the assessment was not complete until the Notice was sent. The form of the notice of assessment does not matter. Subsection 152(2) of the Act requires that the notice be expressed in terms that will clearly make the taxpayer aware of the assessment by the Minister (*Stephens Estate* 87 D.T.C. 5024 (F.C.A.)).

2.3 Why is the Distinction Important?

When reading the *Act* for purposes of certain sections, (e.g. collection restrictions in Section 225.1), it is important to recognize the distinction between and significance of references to assessment and notice of assessment. The Minister's obligation in some cases is to "assess". The quotes from the jurisprudence indicate that the Minister must compute the liability but not

necessarily inform the taxpayer. In other cases, the *Act* specifically requires the issuance of a notice of assessment which presumes a calculation. It also means that only a piece of paper must be sent to the taxpayer. In *Beaudoin* 95 D.T.C. 5364, the Federal Court of Appeal determined that the Minister was not permitted to collect unless Canada Revenue Agency could satisfactorily prove that the Notice of Assessment underlying the Certificate and Writ of Execution had been mailed out.

There is also a distinction between an assessment and a reassessment. The *Act* uses both terms. However, under subsection 248(1), an "assessment" includes a reassessment.

It is important to distinguish between the assessment and the liability for tax. Taxpayers have frequently argued that their liability has been eliminated because of the failure to assess. Unless the *Act* specifically mandates an assessment, the liability exists whether or not an assessment has been made or a notice of assessment issued. The following decisions have stated that the liability to pay tax under the *Act* arises before any assessment has been made or even before a return has been filed:

> *G.R. Block Research and Development (1981) Corporation et al. v. MNR* 87 D.T.C. 5137 (F.C.T.D.);
>
> *Bechthold Resources Limited v. MNR* 86 D.T.C. 6065 (F.C.T.D.);
>
> *The Queen v. Simard-Beaudry Inc.* 71 D.T.C. 5511 (F.C.T.D.);
>
> *Louis Riendeau v. The Queen* 91 D.T.C. 5416 (F.C.A.);
>
> *Algoa Trust v. The Queen* [1993] 1 C.T.C. 2294 (T.C.C.).

Statements made by the Supreme Court of Canada in *Markevich* 2003 SCC 9 seem to call this conclusion into question and suggest that the liability to pay tax arises after the notice of assessment has been issued.

3. <u>"Sending" A Notice of Assessment</u>

Subsection 152(2) of the *Act* states that the Minister shall send a Notice of Assessment to the person by whom the return was filed.

Subsection 244(14) provides as follows:

> "For the purpose of this Act, the day of mailing of any notice or notification described in subsection ... or of any notice of assessment shall be presumed to be the date of such notice or notification."

As well, subsection 244(15) provides:

> "Where any notice of an assessment has been sent by the Minister as required by this Act, the assessment shall be deemed to have been made on the day of mailing of the notice of assessment."

These sections were relied on by the Minister in *McIntyre v. MNR* 93 D.T.C. 999 (T.C.C.). The Minister was unable to prove that notices of reassessment within the normal reassessment period had been sent to the taxpayer's address. In *McIntyre*, the notice of reassessment had the taxpayer's correct address on it but the taxpayer testified that the notice was not delivered to that address within the time limit set out in the *Act*. In fact, the Minister's own file showed that the assessment was returned with a "change of address" stamp on it. The Court held that the Minister had not fulfilled his duty under subsection 152(2) that the notice of assessment must be sent to the person by whom the return was filed. The decision of *Lawrence B. Scott v. MNR* 60 D.T.C. 1273 (Ex. Ct.) is also authority for the principle that an assessment has not been completed where the notice of assessment was sent to a wrong address or a fictitious address.

Two other cases illustrate the significance of this concept. In *A.G. of Canada v. Bowen* 91 D.T.C. 5594 (F.C.T.D.), the taxpayer objected to a reassessment. While the taxpayer was away, Canada Revenue Agency confirmed the reassessment. When taxpayer returned to Canada, Canada Revenue Agency had undertaken collection activity. The taxpayer successfully applied to the Tax Court for an extension of time to file an appeal (90 D.T.C. 1625). The Federal Court of Appeal reversed that decision stating that the requirements of subsection 165(3) had to be followed. The taxpayer had not done so and was thus barred from appealing the confirmation. The taxpayer could not "lay at the Minister's feet" his failure to provide a current mailing address. In *A.B.P. Administration (S.A.) Ltee v. The Queen* 95 D.T.C. 684, the taxpayer applied to the Tax Court for an extension of time to file a notice of objection. The taxpayer was successful because Canada Revenue Agency had sent the notice of assessment to the wrong address. However, in *Denelzen v. The Queen* 98 D.T.C. 6568 (F.C.A.), the taxpayer was unsuccessful where the taxpayer provided the wrong address. Overall, the case law seems to indicate that the burden of proof is on the Minister to show the existence of the notice of assessment and the date of mailing. Yet the burden rests on the taxpayer to submit the correct mailing information. If no notice has been "received" no time periods begin to run.

For discussions of the law see *Tomaszewski v. The Queen* 2004 D.T.C. 2063 (T.C.C.), *Grunwald v. The Queen* 2004 D.T.C. (T.C.C.); affirmed F.C.A; leave to appeal to S.C.C. denied, *236130 British Columbia Ltd.* 2008 F.C.A. 352, *Gebele* 2006 D.T.C. 2095 (T.C.C.); *Burstein* 2009 CCI 103 (T.C.C.) and *Skalbania* 2009 TCC 576. The onus of proof to show the notices were mailed falls on the Crown (*Aztec Industries* 96 D.T.C. 6044 (F.C.A.)). See also *Schafer v. The Queen* [1998] GSTC 60 (T.C.C.) and *Kovacevic v. The Queen* 2003 FCA 293 (F.C.A.). Knowledge of the claim by the Minister does not amount to the mailing of notices of assessment. The pickup of an assessment from the Agency by courier does constitute making and sending of the assessment (*VIH Logging Ltd.* 2004 D.T.C. (T.C.C.)).

4. Assessment "At Any Time"

Certain sections of the *Act* state that the Minister may assess "at any time" (such as section 160). The use of this phrase stands in sharp contrast with the specific wording in section 152 concerning the normal assessment period. In *E.N. Price Ltd. v. The Queen* 82 D.T.C. 6320

(F.C.T.D.), the Court held that the words should be given their literal meaning. In other words, there is no limitation period for assessment where the *Act* provides that the Minister may assess "at any time". This conclusion was confirmed in the section 160 decision of *Davis v. The Queen* 94 D.T.C. 1934 (T.C.C.). Liability under section 160 is discussed below.

The Minister may assess tax at any time under Part XIII. Part XIII places a tax on non-residents of Canada who earn certain types of income in Canada such as rent, interest and dividends. Part XIII places an obligation on the Canadian payor to deduct and remit the tax. Under subsection 227(10), the Minister may assess the Canadian resident payor at any time for an amount payable under Part XIII and may assess the non-resident at any time under subsection 227(10.1). These subsections did not formerly contain any specific time limit and did not specifically permit an assessment "at any time".

5. Assessment or "Determinations" of Partnerships (Subsections 152(1.4) to (1.8))

The Act also contains rules for the assessment of partnerships. Under subsection 152(1.4), Canada Revenue Agency may assess a partnership (as opposed to the partners) within 3 years after the date on which the partnership was obligated to file an information return or the date it was filed, whichever is later. This assumes that the partnership has filed the information return required by section 229 of the Regulations. The power given to the Minister is to determine any matter that is relevant to the determination of the partnership income or to the amounts payable to the partners. Subsection 152(1.7) provides the assessment is binding on each member of the partnership. The date of mailing of the determination will be presumed to be the date of the determination. See *Cummings* 2009 D.T.C. 1178.

Once the assessment is made, subsection 152(1.5) requires Canada Revenue Agency to send a notice of assessment to the partnership **and to each partner**. The *Act* does not specify the address of the partnership for this purpose but presumably it will be the address on the partnership information return (T5013). Subsection 152(1.6) states that the assessment is not invalid only by reason of the fact that some of the partners did not receive a notice. Subsection 244(20) also contains new rules relating to service on the partnership and membership of the partnership which may conflict with subsection 152(1.5).

Canada Revenue Agency may attack transactions on the basis that the partnership did not exist or a person was not a member of a partnership. If a court agrees that no partnership exists or that any person was not a member of the partnership, then under subsection 152(1.8), Canada Revenue Agency has one year from the date on which the decision is made to assess any taxpayer as a result of the decision.

Subsection 165(1.15) will permit the individual partners to object even though the assessment is made against the partnership. This is an important provision because at the time of the assessment, it may be difficult for a partner to locate the other partners so that the partnership as a whole can object.

6. Contrary Assessments

6.1 Different Treatment in Different Years

The case law is quite clear that it is open to Canada Revenue Agency to assess one way in a particular year and then assess in a contrary way in another year. In other words, there is no *res judicata* against Canada Revenue Agency. (*Brad-Lea Meadows Ltd.* 90 D.T.C. 1269, *Waxman Estate v. MNR* 94 D.T.C. 1216 (T.C.C.) and *Carr v. MNR* 94 D.T.C. 1067 (T.C.C.)). In *Carr*, the taxpayer was a lawyer. He owned shares on V-Day. He sold the shares in two different tax years. He unsuccessfully argued that because Canada Revenue Agency assessed the first time on a high V-Day value, Canada Revenue Agency was bound to assess him with the same value the second time.

In *Ludmer v. The Queen* 95 D.T.C. 5035 (F.C.A.), the taxpayers had borrowed money to purchase shares of a foreign corporation. In the first few years after the purchase, Canada Revenue Agency permitted the taxpayers to deduct the interest expense. Canada Revenue Agency subsequently disallowed the deduction and the taxpayers appealed. The Tax Court dismissed the appeal and the taxpayers further appealed. The Federal Court of Appeal decision related to a motion by the Crown to have struck certain allegations in the statement of claim. The Crown's motion was successful.

In *Ludmer*, the taxpayer claimed that Canada Revenue Agency was bound by its earlier assessments. In making this argument, the taxpayer raised a number of issues. One of the taxpayer's allegations was that because Canada Revenue Agency had allowed the interest deductions for taxation years prior to 1981, Canada Revenue Agency had given them a kind of undertaking which bound Canada Revenue Agency for subsequent years. The taxpayers stated that they had relied on this undertaking. The Court held that even if an undertaking existed, it could not relate to a question of law contrary to the statutory provision (i.e. paragraph 20(1)(c)). In addition, if the taxpayer were to be permitted to make this set of allegations, the Minister would be deprived of his undisputed entitlement to assess each individual taxation year independently (subsection 152(4)). Finally, for an undertaking to be binding on the Crown, it must be obtained in a formal manner such as through a ruling. An assessment does not constitute a "promise" not to take a different view. This first allegation, therefore, was ordered to be struck from the taxpayers' statement of claim.

6.2 Different Treatment for Different Taxpayers

A second issue in *Ludmer* was whether Canada Revenue Agency's actions to allow other taxpayers to deduct interest in similar circumstances bound Canada Revenue Agency to permit the deduction. The Court held, following *Hokhold v. The Queen* 93 D.T.C. 5339 (F.C.T.D.) that evidence of Canada Revenue Agency's actions with respect to other taxpayers was not relevant.

6.3 Assessments Contrary to Bulletins: No Estoppel vs. Crown

The taxpayers in *Ludmer* also argued that Canada Revenue Agency could not assess in a manner contrary to a position in an interpretation bulletin. The Court held that an interpretation bulletin could be introduced into evidence not for the purpose of binding Canada Revenue Agency but

rather as evidence of Canada Revenue Agency's interpretation and thus support of the taxpayers' position. A similar finding was made in *Taylor* 95 D.T.C. 591 (T.C.C.).

However, in *Consoltex*, 97 D.T.C. 724, His Honour Judge Bowman said the following:

> "It is sometimes said that estoppel does not lie against the Crown. The statement is not accurate and seems to stem from a misapplication of the term estoppel. The principle of estoppel binds the Crown, as do other principles of law. Estoppel *in pais*, as it applies to the Crown, involves representations of fact made by officials of the Crown and relied and acted on by the subject to his or her detriment. The doctrine has no application where a particular interpretation of a statute has been communicated to a subject by an official of the government, relied upon by that subject to his or her detriment and then withdrawn or changed by the government. In such a case a taxpayer sometimes seeks to invoke the doctrine of estoppel. It is inappropriate to do so not because such representations give rise to an estoppel that does not bind the Crown, but rather, because no estoppel can arise where such representations are not in accordance with the law. Although estoppel is now a principle of substantive law it had its origins in the law of evidence and as such relates to representations of fact. It has no role to play where questions of interpretation of the law are involved, because estoppels cannot override the law."

7. Additional Assessment

Subsection 152(4) permits the Minister to "reassess or make additional assessments" within the period set out in the subsection. Understanding this distinction is critical in determining whether to file a new notice of objection once a new notice of reassessment is issued. Yet it is often difficult to determine whether the Minister is "reassessing" the taxpayer or making "additional assessments". In *Abrahams (No. 1) v. MNR* 66 D.T.C. 5451 (Ex. Ct.) the Court held that the Minister may assess or reassess a taxpayer as often as circumstances require so long as the time limits set out in the subsection are satisfied. In that case, the taxpayer appealed to the Court from a first reassessment. Shortly after launching the appeal, the Minister issued another reassessment. The taxpayer also appealed that reassessment to the Court. The second reassessment included the first reassessment plus an additional amount. The Court held that the Minister had the power to make the second reassessment and that the second reassessment in effect displaced the first reassessment. At page 5452, the Court noted as follows:

> "It would be different if one assessment for a year were followed by an 'additional' assessment for that year. Where, however, the 'reassessment' purports to fix the taxpayer's total tax for the year, and not merely an amount of tax in addition to that which has already been assessed, the previous assessment must automatically become null."

Mr. Justice Walsh elaborated on the distinction between a reassessment and an additional assessment in *Walkem v. MNR* 71 D.T.C. 5288 (F.C.T.D.) at page 5292 as follows:

> "I find that the real distinction lies, as implied in the *Abrahams* case, in deciding whether or not the new reassessment completely replaces all previous assessments or reassessments so that there is no longer any issue before the board or court on those previous assessments or reassessments, in which case the board or court no longer has any jurisdiction to hear the original appeal, or whether on the other hand, it is merely an additional assessment for an additional amount, which may perhaps even be based on a different issue, in which case the original assessment or reassessment has not been replaced and the issue arising out of it can still be litigate in leaving to a later date the hearing of an appeal against the second reassessment unless by agreement they are joined for hearing."

In *Lambert v. The Queen* 76 D.T.C. 6373 (F.C.A.), the Federal Court of Appeal agreed that the distinction between a reassessment and a further assessment is that a reassessment is a redetermination of the total amount payable for the year, whereas a further assessment is a determination of an additional amount payable for that year.

It should be noted that this analysis applies on a taxation year by taxation year basis. Accordingly, a reassessment for a subsequent year has no effect on a previous year's reassessments. This was the conclusion of the Court in *The Queen v. W.H. Violette Limited* 88 D.T.C. 6025 (F.C.T.D.). In that case, the taxpayer was reassessed for the same amount in two difference taxation years on the basis that it was unclear to which year the amount related. The taxpayer ultimately attempted to argue that one reassessment nullified the other. Yet the Court disagreed and stated that a reassessment for one taxation year cannot be taken to supersede a reassessment for a previous taxation year.

8. "Waiver Assessing"

Canada Revenue Agency may threaten to issue an assessment or reassessment unless the taxpayer delivers a waiver in respect of one or more issues relating to one or more taxation years. Regrettably, the Federal Court determined that this does not result in an abuse of process (*Stecko v. The Queen* 95 D.T.C. 5215 (F.C.T.D.)). The Tax Court has further determined that there is nothing wrong with this process and the Minister's conduct did not evidence bias or a lack of good faith (*Costby v. MNR* 94 D.T.C. 1561). It is uncertain whether the Tax Court has jurisdiction to pronounce on the nullity of waivers even if a waiver is obtained under duress or through misrepresentation (*Qureshi v. MNR* 92 D.T.C. 1150; *Placements Marcel Lapointe Inc. v. MNR* 93 D.T.C. 821).

PART III - LIMITATION PERIODS FOR REASSESSMENT

Even though Canada Revenue Agency may assess a return in a particular way, the Minister is not estopped from reaching a different conclusion at a later time. The *Act* contains a series of rules

which outline the circumstances in which Canada Revenue Agency may issue a Notice of Reassessment. The Notice of Reassessment (or Assessment) may reflect tax, interest (arrears and /or instalment) and penalties payable. Alternatively there may be a "Nil Assessment", namely a notification that no tax is payable.

1. General Rule: Limited Right of Reassessment (Subsections 152(4), (4.01) and (5))

Subsections 152(4), (4.01) and (5) of the *Act* create a series of limitations on assessment. The Minister is prohibited from reassessing, making an additional assessment or assessing tax, interest or other penalties beyond the "normal reassessment period" except in extraordinary circumstances described in subsection 152(4), (4.1)-(4.3) and discussed below. But for these restrictions, the Minister may generally perform these functions in certain circumstances within one of 3 time periods:

- at anytime (subsection 152(4))
- within 3 years after the end of the normal reassessment period (paragraph 152(4)(b) and subsection 152(6))
- before the expiry of the normal limitation period (subsection 152(4)).

Subsections 152(4.2) and (4.3) also permit consequential reassessment beyond the normal reassessment period in certain prescribed situations. Other parts of the *Act* incorporate all of these sections of the *Act* by reference so that limitations on assessments of taxes, interest and penalties imposed by other parts of the *Act* are equally applicable.

2. "Normal Reassessment Period"

Subsection 152(3.1) contains a definition of "normal reassessment period". For mutual fund trusts or corporations other than CCPCs, the normal reassessment period ends "4 years after the day of mailing of a notice of an original assessment ... or the day of mailing of a notification that no tax is payable". For all others (CCPCs, personal trusts, individuals), the normal reassessment period is 3 years rather than 4. Subsection 152(5) limits the Minister's ability to assess after the "normal reassessment period" unless the Minister is assessing under one of the exceptions in subsection 152(4).

With respect to the normal reassessment period, it is important to determine the date on which the period begins. The period begins either on the day of mailing of a notice of an "original assessment" or on the day of mailing of a "notification" that no tax is payable. Neither of these will usually occur if the taxpayer has not filed a tax return and accordingly, there is no time limit for an assessment or reassessment of tax where no return is filed. The *Act* does not define "original assessment" but presumably, it means the first assessment of the return for the particular year. This is, in most circumstances, the notice of assessment issued under subsection 152(2). In determining when the normal reassessment period begins, the rules set out in subsection 244(14) of the *Act* must also be considered. Under the definition of "normal reassessment period", the relevant day is the day of mailing of the notice or notification to the taxpayer. Under subsection 244(14), the date appearing on the notice of assessment or the

notification that no tax is payable, as the case may be, will be presumed to be the day of mailing. In *Hughes v. MNR* 87 D.T.C. 635 (T.C.C.), the Tax Court confirmed that subsection 244(14) contains a presumption that can be rebutted by the taxpayer by adducing evidence to the contrary. For a miscalculation by the Tax Court of the period, see *The Queen v. Gray* 2008 FCA 284.

3. Extraordinary Reassessment Periods

3.1 Misrepresentation or Fraud: Forever

The *Act* contains a number of provisions which specifically provide that the normal reassessment period does not apply. First, the taxpayer may allow Canada Revenue Agency to reassess beyond the normal reassessment period when the taxpayer has filed a waiver in prescribed form (T2029) (under subparagraph 152(4)(a)(ii)). Second, the Minister may reassess "at any time" where the taxpayer or person filing the return:

> "has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in the filing of the return or in supplying any information under this Act".

3.1.1 Misrepresentation

To reassess beyond the normal reassessment period, the Minister must first establish that there has been a "misrepresentation". It should be noted that this will often be a low threshold as the misrepresentation may be innocent. In *MNR v. Taylor* 61 D.T.C. 1139 (Ex. Ct.), Mr. Justice Cameron stated as follows:

> "I have reached the conclusion that the words 'any misrepresentation' as used in this section, must be construed to mean any representation which was false in substance and in fact at the material date, and that it includes both innocent and fraudulent misrepresentations."

It should be noted that it is not simply a matter of reviewing statements made in the return to determine if any of them constitute a misrepresentation. Mr. Justice DuMoulin explained in *MNR v. Appleby* 64 D.T.C. 5159 (Ex. Ct.) at page 5203 as follows:

> "A misrepresentation may consist just as well in the concealment of that which should be disclosed as in the statement of that which is false, for 'misrepresentation' unquestionably may be made by concealment. If the nondisclosure of a material fact which the representor is bound to communicate is deliberate then misrepresentation is fraudulent; if it is unintentional it is nonetheless a misrepresentation though an innocent one."

As a result, the first requirement is to establish that the return contains a false statement or that the taxpayer failed to disclose a material fact in his or her return.

3.1.2 Attributable to Neglect, Carelessness or Wilful Default

The next step in the analysis is to determine whether the misrepresentation is "attributable to neglect, carelessness or wilful default". This essentially requires a two-stage analysis. First, the Minister must establish that the taxpayer's actions constituted either neglect, carelessness or wilful default. Second, the Minister must draw a connection between the misrepresentation and the action of the taxpayer. In the words of the statute, the misrepresentation must be "attributable" to neglect, carelessness or wilful default. This subparagraph refers to a spectrum of conduct. At one end of the spectrum, the subparagraph specifically contemplates that returns of income will have errors contained in them.

Perhaps the leading case on what constitutes neglect in this context is *Lucien Venne v. The Queen* 84 D.T.C. 6247 (F.C.T.D.). This case is particularly illuminating because the Court found the taxpayer to have made a misrepresentation resulting from "neglect" but refused to permit the imposition of penalties thus concluding that the taxpayer was not grossly negligent. In this case, the taxpayer was reassessed beyond the normal limitation period because he had failed to report approximately $50,000 of income. The taxpayer defended by stating that he was a man of limited education and relied solely on his bookkeeper. The Court held that the taxpayer's neglect resulted because he failed to read his return before signing it. Moreover, the errors in the returns were sufficiently obvious that a reasonable man of even a limited education would have noticed the errors if he had read the return. However, the Court refused to permit the imposition of the penalties because penalties required the taxpayer to have made the misrepresentation either "knowingly" or "under circumstances amounting to gross negligence". Certainly, the taxpayer did not knowingly underreport his income.

With respect to the issue of reassessment beyond the normal reassessment period Mr. Justice Strayer at page 6251 stated as follows:

> "Such negligence is established if it is shown that the taxpayer has not exercised reasonable care. This is surely what the words 'misrepresentation that is attributable to neglect' must mean, particularly when combined with the ground such as 'carelessness' or 'wilful default' which referred to a higher degree of negligence or to intentional misconduct. Unless these words are superfluous in this section, which I am not able to assume, the term 'neglect' involves a lesser standard of deficiency akin to that used in other fields of law such as the law of tort."

His Honour Judge Taylor defined "neglect" in *Glazier Ltd. v. MNR* 83 D.T.C. 48 at 50:

> "To pay little or no respect or attention to; to fail to bestow proper attention or care upon; to admit through carelessness ..."

"Carelessness" he defined to mean the following:

> "Inattentive, thoughtless, indifferent and unconcerned ..."

There has not been a decision in which a Court has carefully examined in detail the phrase "wilful default". Presumably this is because the word "wilful" implies intention in which case it requires a higher standard of proof for Canada Revenue Agency than mere "carelessness".

Yet not every error will permit Canada Revenue Agency to reassess beyond the normal reassessment period. For example, in *C.E. Reilly Estate v. The Queen* 84 D.T.C. 6001 (F.C.T.D.), the taxpayer failed to report a disposition of real property. When reassessed on the basis that the failure to report the disposition resulted in misrepresentation attributable to carelessness or wilful default, the taxpayer appealed. The accountant who prepared the taxpayer's return testified that in preparing the return he had reviewed the 1972 taxation guide published by Canada Revenue Agency. The Court stated that the accountant's conclusion that the disposition of land was not reportable did not result in wilful default because he intended no such thing. To the Court, the accountant's careful review of the guide was exactly the opposite of what was meant by neglect and carelessness.

The Courts have consistently held that the Minister must establish that a misrepresentation attributable to neglect, carelessness or wilful default has occurred. In *Markakis v. MNR* 86 D.T.C. 1237 (T.C.C.), the taxpayer was successful on two of the three years in question because Canada Revenue Agency admitted that it had destroyed the taxpayer's returns. The Court held that it was thus impossible to determine whether a misrepresentation had been made in those returns. With respect to the third and final year, the Court did not accept it, stating that a misrepresentation due to neglect or carelessness did not result simply from the fact that the taxpayer made deposits in his bank account greater than his income for that taxation year. Similarly, in *Poulin v. MNR* 87 D.T.C. 113 (T.C.C.), the Minister was unable to show that the taxpayer had made any "misrepresentation" regarding his taxable income. In finding in favour of the taxpayer, the Court noted that it is not simply neglect, carelessness or wilful default which permits a reassessment beyond the normal reassessment period but rather, it is a "misrepresentation" which arises from neglect, careless or wilful default in filing the return or supplying any information under the *Act*. Thus, Canada Revenue Agency must establish both that there was a misrepresentation and that misrepresentation was attributable to neglect, carelessness or wilful default.

In the event that the Minister assesses beyond the normal reassessment period, the Minister has an initial onus to establish that there has been at least one misrepresentation or that there has been some fraud committed in filing the return. The onus then shifts to the taxpayer to establish that the Minister has gone too far because a particular income inclusion did not result from the misrepresentation or from fraud.

3.1.3 As a Defence, Can You Rely on Hiring Your Accountant to File the Tax Return?

A practical issue which arises is whether the taxpayer is open to reassessment for misrepresentation if he or she relied on another person who prepared the return. This was the taxpayer's defence in *Can-Am Realty Limited v. The Queen* 94 D.T.C. 6293 (F.C.T.D.) referred to above. The Court in *Can-Am* reiterated the principle in *Howell v. MNR* 81 D.T.C. 230 (T.R.B.) that a taxpayer is ultimately responsible for his or her return. A taxpayer may not simply sign the return but where it is within his or her competence must review the return for errors and omissions. The taxpayer in *Can-Am* had an additional problem. The Court found that

the reason for the accountant's omission of income was that the documentation provided to the accountant was confusing. As a result, on this issue, the taxpayer was not successful. This was also the finding of the Tax Court in *Hougassian v. The Queen* 2007 D.T.C. 823. This was equally the findings of the Tax Court in *DeCock v. MNR* 84 D.T.C. 1523 and *DeCosta v. The Queen* 2005 D.T.C. 1436. See also *Saunders* (January 23, 2006 (T.C.C.)) in the context of a subsection 163(1) penalty.

Each case will depend on its own facts. However the trend in the jurisprudence has been moving away from favouring the taxpayer. This is evident from comments made by the Federal Court in *Nesbitt v. Canada* 96 DTC 6588 and the Tax Court in *Snowball v. The Queen* [1996] 2 CTC 2513. In the latter case former Chief Justice Bowman said that a taxpayer can't shield himself by blaming his accountant.

This issue again resurfaced in an August 19, 2009 decision of Mr. Justice Bowie of the Tax Court of Canada styled *College Park Motors Ltd. And Joseph Alan Holdings Ltd. v. The Queen*.

2009 TCC 409. Doug Ulmer ("Ulmer") was one of the principals of the Ulmer Group of companies (the "Ulmer Group") of which the corporate taxpayers College Park Motors Ltd. ("CPMP") and Joseph Alan Holdings Ltd. ("JAH") were members. Baert, a chartered accountant, was the accountant for the Ulmer Group. CPMP operated a car dealership and JAH was a holding company established to hold real estate to be rented to the corporate members of the Ulmer Group. In its return for 1999 CPMP failed to file Schedule 33 capital returns, failed to compute and report its Part I.3 capital tax liability, and claimed an entitlement to the small business deduction ("SBD") to which it was not entitled. JAH made similar errors in its return for 2000. Both returns were signed by Ulmer in Baert's office.

Upon discovering these errors in the latter part of 2003, Ulmer instructed tax counsel to make voluntary disclosure to the Minister, and to re-calculate the Ulmer Group's capital tax liability, which was done in June, 2004.

In reassessing both CPMP's return for 1999 and JAH's return for 2000, beyond the normal reassessment period, the Minister imposed Part I.3 tax, and disallowed the SBD's claimed. On appeal the taxpayers did not contest the accuracy of the Minister's reassessments, but alleged that neither of them had made misrepresentations justifying reassessments beyond the normal reassessment period.

In dismissing the Appeals, Justice Bowie concluded that: (a) the purpose of the exception to the normal reassessment period is to preserve the Minister's right to reassess in situations where a taxpayer had not divulged everything as accurately as he should have, thus denying the Minister's right to determine correctly his tax liability; (b) this exception has nothing to do with establishing culpability on the taxpayer's part; (c) in the present case Ulmer knew all of the facts pertaining to the taxpayers' business affairs; (d) neither Ulmer nor Baert, however, knew anything about Part I.3 tax, and this failure on their part to inform themselves about the tax and to read the taxpayers' returns carefully before they were signed, led to the taxpayers claiming SBDs to which they were not entitled; and (e) the Minister, therefore was justified in reassessing the taxpayers beyond the normal reassessment period.

The last three significant paragraphs (18-20) of the Reasons shows the mindset of the Tax Court:

> [18] Mr. Bouvier does not suggest that willful default or fraud is a factor in this case, but he does suggest that carelessness or negligence led to the omissions, and to the claim for a deduction to which the taxpayers were not entitled. Mr. Wintermute argues that if there was negligence then it was that of Mr. Baert and not Mr. Ulmer. Neither of them knew anything about Part 1.3 of the Act, nor could they be expected to. Part 1.3 was added to the Act in 1989, and it had not been a factor in Mr. Baert's practice prior to these cases. Mr. Ulmer is a businessman, not a lawyer or an accountant, and there was no reason for him to have any knowledge of the tax on large corporations, or even to think of any member of the Group as being a large corporation. None of that excuses their failure to react to the questions relating to Part 1.3 on the second page of the T2, however.
>
> [19] If Mr. Ulmer had reviewed the draft returns as carefully as a wise and prudent taxpayer would, then he would have read the questions on page 2 and he would have seen there the questions relating to Part 1.3 tax. Not knowing what they referred to, he would have asked Mr. Baert what Part 1.3 tax is, and he would have learned that Mr. Baert did not know either. At that point they would have referred to the guide item 115, or some other source, and they would have learned that the answers to two of the questions relating to Part 1.3 should be "yes", that the Part 1.3 return should be filed with the T2 return, and that the small business deduction was not available to the appellants. It is immaterial whether the carelessness lies in failing to read all the questions on page 2, or, having read the questions, in failing to make the necessary inquiries to find out what Part 1.3 tax is all about. In either event, he did not take the required degree of care.
>
> [20] At the risk of redundancy, I wish to reemphasize that the purpose of subparagraph 152(4)(a)(i) is not penal but remedial. It balances the need for taxpayers to have some finality in respect of their taxes for the year with the requirement of a self-reporting system that the taxing authority not be foreclosed from reassessing in those instances where a taxpayer's conduct, whether through lack of care or attention at one end of the scale, or willful fraud at the other end, has resulted in an assessment more favourable to the taxpayer than it should have been. This, quite rightly, is not a penalty case. It is simply a case where the fisc should not be deprived simply by reason of the passage of time between Mr. Ulmer's innocent mistake and his discovery of it, and resulting voluntary disclosure.

3.1.4 Summary

In summary, the following is a synopsis of the principles which flow from this area:

- Wilful default or recklessness involves a higher degree of negligence than not exercising reasonable care.

- Negligence requires a tort standard of "reasonable care" based on conduct undertaken by third parties (*Werry v. MNR* 94 D.T.C. 1279 (T.C.C.)).

- Misrepresentation can include an error created through an honest but erroneous belief (*Can-Am*).

- Misrepresentation generally arises in cases where the taxpayer has few or poorly-kept records.

- Misrepresentation attributable to neglect does not include deliberate, thoughtful and *bona fide* non-reporting by the taxpayer who thoughtfully and carefully assessed the situation and determined reporting was not required (*1056 Enterprises v. The Queen* 89 D.T.C. (F.C.T.D.)).

- A sham will entitle Canada Revenue Agency to reassess as a misrepresentation attributable to neglect or wilful default if the actions of the taxpayer differ from the legal relationship to which the taxpayer was ostensibly a party (*Farm Business Consultants Inc. v. The Queen* 95 D.T.C. 200 (T.C.C.)).

- Misrepresentation attributable to neglect may not be as easy for the Crown to prove in valuating cases. See *Petric* 2006 TCC 306.

- Reliance on an accountant's preparation may not immunize a taxpayer from penalty or reassessment (*Nesbitt, Gestion Foret-Dale* 2009 TCC 255, *College Park Motors, Saindon* 2009 TCC 302)

What about the pleading of "misrepresentation" and the associated burden of proof? See *Taylor* [1961] C.T.C. 211 (F.C.T.D.); *Naguib* 2004 FCA 40 and *Trojan* 2006 TCC 2.

3.2 Six or Seven Years?

Under paragraph 152(4)(b) the Minister may reassess before the day that is 3 years after the expiration of the normal reassessment period for the taxpayer in the following circumstances:

- The taxpayer has made use of certain elective provisions referred to in subsection 152(6) of the *Act* to have its immediately previously filed return amended to take account of deductions in respect of certain losses, expenditures and tax credits realized in a subsequent year and carried back to the particular taxation year. Under paragraph 152(4)(b), the Minister may reassess the taxpayer as a result of the taxpayer's use of the carrybacks described in subsection 152(6).

- There is reason to assess or reassess the taxpayer for any relevant taxation year as a consequence of an assessment or reassessment of another taxpayer pursuant to subsections 152(4) or 152(6).

- There is reason to assess or reassess the taxpayer for a taxation year as a result of a transaction between the taxpayer and a non-arm's length non-resident. (See *SMX Shopping Centre Ltd.* 2004 D.T.C. 6013 (F.C.A.) and *Blackburn Radio* 2009 DTC 1099 (TCC) and *Shaw-Almex Industries* 2009 TCC 538 (under appeal))

- There is reason to assess or reassess the taxpayer as a result of a reimbursement by a foreign government in respect of an income tax imposed by that government.

The following example shows how the section applies in the case of a loss carryback by a CCPC:

2003 T2	Fiscal Year-end Dec 31
2004 (June 30)	Filing Deadline
2004 (Oct 31)	Notice of Assessment
2006 T2	Loss (non-capital) Carryback to 2003
2007 (Oct 31)	Normal Limitation Period 152(3.1)/152(5)
2010 (Oct 31)	152(6) Limitation Period

For an analysis of these provisions, see *Agazarian v. The Queen* 2003 D.T.C. 435 (T.C.C.), reversed 2004 D.T.C. 6366 (F.C.A.).

3.3 Request by Taxpayer - Subsection 152(4.2)

Canada Revenue Agency may also reassess beyond the normal reassessment period where requested to do so by the taxpayer under subsection 152(4.2). The subsection, which was added in 1994, applies only to individuals (other than trusts) and testamentary trusts. Under subsection 152(4.2), the taxpayer may apply for a reassessment, a determination of the amount of any refund, or a reduction of the amount payable under Part I of the *Act*. This subsection is useful where, for example, after the expiration of the normal reassessment period, an individual becomes aware of the failure to claim a deduction or credit. The Act limits requests made after 2004 to a 10 calendar year period for adjustments. For application of subsection 152(4.2), see *Gagne* 2007 D.T.C. 5087 (FCTD), *Kubbernus* 2009 D.T.C. 1212 (T.C.C.) and *Berget* 2009 D.T.C. 5007.

3.4 Reassessment After The Filing or Resolution of An Appeal – Subsection 152(4.3)

Subsection 152(4.3) permits Canada Revenue Agency to reassess beyond the normal reassessment period where it is necessary to do so as a result of an adjustment to an amount deducted or included in computing a "balance" of the taxpayer for a particular year. The

"balance" of a taxpayer for taxation year is defined in subsection 152(4.4). The provision permits reassessment of a subsequent year where an assessment or an appeal of a previous year has an impact on a subsequent year. For example, a decision on appeal has changed the amount claimed in a taxation year and this would have an impact on the amount required to be included in the taxpayer's income in a subsequent year. That subsequent year may have already become statute-barred while the year under appeal proceeded to Court. Under subsection 152(4.3), the Minister now has the power to reassess the subsequent year. For a discussion regarding the scope of subsection 152(4.3), see *Alameda Holdings Inc. v. The Queen* 2000 D.T.C. 1544 (T.C.C.), *Sherway Centre v. The Queen* 2003 D.T.C. (F.C.A.), *Bulk Transfer Systems Inc. v. The Queen* 2004 D.T.C. (T.C.C.), *Hevey* 2005 D.T.C. 203 (T.C.C.) and *LJP Sales Agency* 2007 FCA 114. See also Technical Interpretation 2005-0122381E5 (February 7, 2006) regarding CRA's view of the scope of subsection 152(4.3).

3.5 Waivers

3.5.1 Content

The prescribed form for a waiver is T2029 and is entitled "Waiver in Respect of the Normal Reassessment Period". Prior to amendments passed in 2009, the waiver always had to be filed before the end of the "normal reassessment period." Now it may also be filed within the 3 year additional period. In the prescribed form, the taxpayer is required to disclose the following information:

- the part of the *Act* in respect of which the normal reassessment period is waived; and

- the subject matter in respect of which the assessing period is being waived.

Canada Revenue Agency auditors will often complete the waiver and ask the taxpayer to sign it. It is of benefit to review the waiver prior to having it filed with Canada Revenue Agency because Canada Revenue Agency may have drafted the waiver more broadly than the actual issues under consideration.

If the waiver is drafted too broadly, issues that were not previously discussed may be subject to a reassessment beyond the normal reassessment period. Under paragraph 152(4.01)(a), the Minister is limited in reassessing beyond the normal reassessment period in the case of a waiver to the issues contained in the waiver. The courts have generally not let taxpayers "weasel" out of waivers by trying to prove that they have limited scope. In both *Bailey v. MNR* 89 D.T.C. 416 (T.C.C.) and *Placements T.S. Inc. v. The Queen* 94 D.T.C. 1302 (T.C.C.), the Tax Court held that Canada Revenue Agency could reassess beyond the normal reassessment period even though the basis of the reassessment was not specifically described in the waiver. The purpose of a waiver was to permit Canada Revenue Agency to continue to review a transaction and not to bind it to an issue. In *Cal Investments Limited v. The Queen* 90 D.T.C. 6556 (F.C.T.D.), the Court rejected the argument that the waiver was invalid because it was not executed under a corporate seal. See also *Chafetz, Jordan and Taylor* 2006 D.T.C. 2119 (T.C.C.) affirmed 2007 FCA, *Holmes* 2005 D.T.C 985, (T.C.C.), *Honeywell* 2007 FCA 22 and *McGonagle* 2010 FCA 108 regarding the scope of waivers.

For a discussion of what constitutes a "waiver" see *Mitchell* 2002 FCA 407. In that case correspondence between the taxpayer and the Crown was considered a waiver of limitation periods to permit the Crown to reassess a taxation year favourably for a taxpayer whose taxation year was otherwise barred from reassessment.

3.5.2 Signature

In *Loyens v. The Queen* 2003 D.T.C. 807 (T.C.C.), the signature by a brother of the taxpayer was not accepted. Signature must be by a taxpayer or "legal representative". See for example *Mitchell*, supra. A waiver was still considered valid even though allegedly signed by an officer who lacked the authority to do so (*Arpeg Holdings* [2006] TCJ No. 470 affirmed 2009 FCA 31). A waiver signed by an accountant on behalf of a taxpayer was also considered valid in *Ackaoui v. The Queen* 2005 TCC 416. A taxpayer's misunderstanding of language in a waiver is no defence to the waiver's application (*Sljivar* 2009 T.C.C. 581).

3.5.3 Waivers and The Extended Reassessment Period

Even if the limitations period is extended under paragraph 152(4)(b), the waiver must be provided before the expiry of the normal reassessment period (3, 4, 6 or 7 years). The latter changes become effective on March 12, 2009 with the enactment of paragraph 152(4)(c).

3.5.4 Revocation of Waivers – Subsection 152(4.1)

A waiver may be revoked. The prescribed form for revocation of a waiver is T652, "Notice of Revocation of Waiver". Under subsection 152(4.1), the Minister then has six months after the date on which the revocation is filed to reassess the taxpayer on the issues which were the subject of the waiver.

3.5.5 Strategies Regarding Waivers

There are a number of issues to consider before providing a waiver. A taxpayer may be leery to grant a waiver because of as yet undiscovered aggressive positions taken in a tax return. This must be weighed against the fact that it may be easier to negotiate with Canada Revenue Agency before a reassessment has been issued. As well, large corporations must pay 50% of any amount assessed in spite of the filing of a Notice of Objection. A taxpayer might also consider filing more than one waiver. This will provide flexibility later on for the revocation of a waiver as separate revocations can be filed for each of the issues being discussed with Canada Revenue Agency. Taxpayers sometimes file the T652 Revocation at the same time as the T2029 Waiver is delivered to limit the potential reassessment period to a further 6 months. This practice has been referred to as a "stapled waiver". A taxpayer affected by provincial tax legislation in Ontario, Quebec and Alberta should consider the need to file waivers and revocations separately with these tax authorities or whether documents filed with Canada Revenue Agency will keep taxation years open for reassessment.

Where discussions with Canada Revenue Agency over various issues continue for an extended period, the Agency may ask the taxpayer for a waiver. Under subparagraph 152(4)(a)(ii), the Minister is permitted to assess tax, interest or penalty for a taxation year, at any time if the taxpayer has filed with the Minister a waiver in prescribed form for that taxation year within the

"normal reassessment period". Under subsection 152(5) the Minister may not include in income any amount that cannot reasonably be regarded as relating to a matter specified in the waiver. For further discussion regarding waivers, see Tari, "Waivering" 2002 Canadian Tax Foundation Annual Report.

3.6 Tax Shelter Assessments

The Act sets out detailed rules for the taxation of "tax shelter investments". Subsection 143.2(15) permits reassessments without any time limitations.

3.7 Notification That No Tax is Payable - Any Limitation Period?

While the *Act* refers to a "notification that no tax is payable", most practitioners refer to the notice as a "nil assessment". The phrase "notification that no tax is payable" is not defined in the *Act*. The effect of receiving such a notification or a nil assessment was set out in *Irving Oil v. The Queen* 88 D.T.C. 6138 (Appeal dismissed by the F.C.A. 91 D.T.C. 5106) as follows:

> "In truth, despite the expression 'nil assessment' in the *Gary Bowl* case 74 D.T.C. 6401, it appears that there is no such thing. Subsection 152(4) of the *Act* indicates that the Minister may assess tax, interest or penalties ... or notify in writing ... that no tax is payable for the taxation year ... if a compressed expression can be needed, the latter instrument ought really to be called a 'nil notification' since the Minister does not assess tax thereby. There is no right of appeal from a 'nil notification'. The Minister causes confusion by persisting in overusing 'notice of assessment' forms for what subsection 152(4) of the Act indicates is a mere 'nil notification'."

It is with respect to notifications that no tax is payable that confusion arises. A notification that no tax is payable relates to the taxpayer's liability for a particular taxation year. For that particular taxation year, Canada Revenue Agency must reassess within the "normal reassessment period". Subject to any of the exceptions discussed earlier, the Crown must reassess tax, interest or penalties within 3 or 4 years from the notification that no tax is payable. However, Canada Revenue Agency can continue to issue serial notices of reassessment with no tax owing long after the normal reassessment period has expired. The adjustment and the basis upon which no tax is payable may also be in issue long after the expiration of the normal reassessment period. The two most common examples of this occurrence of an extended reassessment period arise with respect to the carryforward of losses and the claiming of capital cost allowance ("CCA").

The leading case with respect to losses is *New St. James Ltd. v. MNR* 66 D.T.C. 5241 (Ex. Ct.). That case held that the Minister is not bound by the assessment of a loss in a statute barred year when reassessing the loss carryforward in subsequent years. The Minister may recalculate the original loss if the loss is taken in subsequent years. This decision is consistent with the fact that the Minister is assessing an amount and not an issue. Accordingly, all factors which determine the amount for a taxation year are open to review by the Minister. This can have the effect of leaving a taxpayer open for reassessment of a loss for considerably longer than the normal

reassessment period. For example, a CCPC with a taxation year of June 30, files its 2004 tax return claiming a non-capital loss. It files its return towards the end of 2004 and on March 31, 2005 Canada Revenue Agency issues a notification that no tax is payable with respect to the 2004 taxation year. Seven years later, in the taxation year 2011, the taxpayer applies this loss against its business income. The Minister assesses the taxpayer on March 31, 2012. The Minister will thus have until March 31, 2015 to reassess the taxpayer with respect to its calculation of the 2004 loss. Some of the events which resulted in that loss will have occurred in 2003, some 12 years before the time of the reassessment.

This is also a common occurrence in CCA claims. The reason that CCA claims can be adjusted after the normal reassessment period is because of the definition of "undepreciated capital cost" ("UCC") in paragraph 13(21)(f). That paragraph provides that a UCC pool is newly calculated every taxation year. It does not bring forward the UCC balance and then permit the taxpayer to claim CCA based on that balance. For example, long after a taxpayer has reduced the UCC of a pool to nil, Canada Revenue Agency could reassess the taxpayer on the basis that the fair market of the capital property was lower than the amount claimed by the taxpayer. This would result in the taxpayer having claimed excessive CCA and recapture would result. The normal reassessment period would not expire until 3 years after the year in which the UCC had been reduced to nil. Similarly, Canada Revenue Agency may recalculate the ACB long after the capital property has been purchased. For example, a taxpayer may purchase capital property in 1975 and then dispose of the capital property in 2005. It is in its 2005 return of income that the ACB will be used to determine the taxpayer's capital gain. Accordingly, Canada Revenue Agency will have until sometime in 2009 to dispute the fair market value of the capital property where it was purchased in a non-arm's length transaction or to dispute any of the adjustments to the ACB of the capital property made pursuant to section 53.

3.8 Reassessment During or Resulting From Objection/Appeal Process

3.8.1 Reassessment After Objection – Subsection 165(3)

Where the taxpayer has filed a notice of objection to an assessment or reassessment, paragraph 165(3)(a) directs the Minister, after reconsidering the assessment or reassessment to vacate, confirm or vary it or to reassess accordingly. It may well be that the normal reassessment period has expired for the taxation year under objection. However, subsection 165(5) provides that a reassessment made by the Minister pursuant to this power is not invalid by reason only of not having been made within the 3 or 4 years from the day of mailing of a notice of original assessment or of a notification that no tax is payable for the year.

3.8.2 Reassessment and Settlement of an Appeal – Subsection 169(3)

Subsection 169(3) of the *Act* permits the Minister to reassess tax, interest, penalties or other amounts payable with the consent of the taxpayer for purposes of disposing of an appeal regardless of the time limitations in subsection 152(4). This provision is used as a means of effecting settlement of multiple taxation years, some of which are affected by taxation years before the Tax Court and which are in need of resolution, even though the court has no jurisdiction to deal with them.

3.9 *Continental Bank* and Subsection 152(9)

Subsection 152(9) permits the Crown to advance new arguments in support of an assessment after the expiry of the normal reassessment period. The provision is intended to ensure that Canada Revenue Agency may, on an appeal of an income tax assessment, identify the basis or further bases on which Canada Revenue Agency is relying in support of its assessment. This amendment was proposed in light of remarks by the Supreme Court of Canada in the case of *The Queen v. Continental Bank of Canada*, 98 D.T.C. 6511 to the effect that the Crown is not permitted to advance a new basis for assessment after the limitation period has expired. The critical issue facing the courts is whether the Minister is advancing an additional argument or new basis for assessment. For recent consideration, see *General Motors Acceptance Corp. of Canada v. The Queen* 99 D.T.C. 975 (T.C.C.); *Smith Kline Beecham Animal Health Inc.* 2000 D.T.C. 1526 (T.C.C.), affirmed 2000 D.T.C. 6141 (F.C.A.); *Pedwell v. The Queen* 2000 D.T.C 6405 (F.C.A.); *Anchor Pointe v. The Queen* 2003 D.T.C. 5512 (F.C.A.); *Loewen v. The Queen* 2004 D.T.C. 6321 (F.C.A.); *The Toronto Dominion Bank v. The Queen* 2008 TCC 284 (TCC); *Walsh v. The Queen* 2008 TCC 282 (TCC); *Walsh v. The Queen* 2007 FCA 22 (leave to the S.C.C. denied on November 29, 2007) and *Lockie* 2010 T.C.C. 142.

Subsection 152(9) is subject to subsection 152(5) which prevents the Minister from including amounts in a taxpayer's income which were not included prior to the expiration of the taxpayer's normal reassessment period. It is also intended that subsection 152(9) be subject to the court protection afforded to taxpayers that an alternative argument cannot be advanced to the prejudice of the right of a taxpayer to introduce relevant evidence to rebut the argument. For further discussion, see the articles by Bendin (2000) 48 C.T.J. 35 at 53 – 57 and Meghji, Grenon and Rowe "Does Procedure Matter" (1999) Conference Report Ch. 15.

3.10 Treaty-Based Limitation Periods

Some tax treaties to which Canada is a party may contain a limitations period for reassessing. (e.g. Luxembourg, Netherlands, Chile). See *Canwest Media Works* 2007 D.T.C. 109 (T.C.C.), reversed by 2008 FCA 5. Query whether the Minister is precluded from reassessing when no relief from double taxation is available under a tax treaty because limitation periods have passes (*Chrysler Canada* 2008 FC 727).

4. Effect of a Reassessment

The issuance of a new notice of assessment nullifies any previous notice of assessment/reassessment, thereby requiring a new notice of objection to be filed (*Bowater Mersey v. The Queen* 87 D.T.C. (F.C.A.)). This administrative action by the Minister does not nullify the previous liability to pay tax even if the reassessment covers the same issues (*Lambert v. The Queen* 76 D.T.C. (F.C.A.)). However, subsection 165(7) permits appeals or objections to be made based on earlier assessments/reassessments that are superseded.

5. Increase of Tax By The Minister Upon Subsequent Reassessment

The Minister may increase the liability of a taxpayer through reassessment or the making of an additional assessment within the parameters of subsections 152(4) and (5) described above. Yet

the Minister may not "appeal his own assessment or reassessment" (*Consumers' Gas* 87 D.T.C. 5008 (F.C.A.)) and increase the amount owing through the Tax Court process once the time periods within subsection 152(4) have elapsed, unless subsection 152(4.3) applies or the taxpayer has consented to the reassessment through subsection 152(4.2) or 169(3) of the *Act*.

6. Loss Determination (Subsections 152(1.1) and (1.2))

A taxpayer may call upon Canada Revenue Agency to provide a loss determination. Under subsection 152(1.1) a taxpayer may request that the Minister determine the amount of the taxpayer's non-capital, net capital, restricted farm, farm or limited partnership loss for a year. The prerequisite for making this request is that Canada Revenue Agency must have ascertained that the amount of the taxpayer's loss is different from the amount reported by the taxpayer. Once the taxpayer requests that the determination be made, the Minister is required to do so with all due dispatch and send a notice of the determination to the person by whom the return was filed. Canada Revenue Agency's administrative position is set out in IT512.

The *Act* does not establish how the taxpayer will know that Canada Revenue Agency disagrees with a loss. For example, the issue surfaces in determinations involving the deductibility of expenses. The taxpayer may know that Canada Revenue Agency will not permit all of the expenses and may want to have Canada Revenue Agency fix the amount of any loss not denied.

When the taxpayer is aware that the Minister disagrees with the calculation of the loss as reported, the taxpayer has two alternatives. First, the taxpayer may request that the Minister determine immediately the amount of the loss pursuant to subsection 152(1.1). Second, the taxpayer may decide to wait until the year in which the loss is claimed. The *Act* does not contain a time limit for requesting a determination. Subsection 152(1.2) provides that the provisions of Division I relate to a determination. As a result, the Minister may re-determine losses as if the determination were a reassessment within defined periods. The taxpayer may also object to a determination in the same manner as for a reassessment and ultimately may appeal the determination to the Tax Court.

The provisions of subsections 152(1.1) - (1.3) are a complete code for requesting a notice of determination of loss. See *Inco Limited* 2005 D.T.C. 5110 (F.C.A.), leave denied to S.C.C.

PART IV - DEALING WITH CANADA REVENUE AGENCY - OVERVIEW

1. Some Prerequisites for Successful Tax Dispute Resolution

A tax lawyer must acquire and use certain tools and skills to effectively negotiate on behalf of the taxpayer. First the tax professional must obtain from the client both a consent (T1013) to deal with Canada Revenue Agency and a well drafted retainer letter. Security for fees is also recommended. In the 1994 CTF Annual Conference Report, Bill Innis concluded that litigating with Canada Revenue Agency involves a number of risks: economic, legal, factual and litigation. Evaluating these risks is critical to the manner in which the tax dispute process is handled. These risks must be continuously evaluated by the tax professional who must also be familiar with the facts, the burden of proof, the limits of the government's powers, prospects of settlement and access to government information.

2. Know the Client and Gain Knowledge of Relevant Facts

A tax professional must attempt to gather facts, information and an awareness of the client, including the credibility of the client and others as witnesses. The professional may then evaluate the appropriateness or need to interface between Canada Revenue Agency and the client. The professional must also endeavour not to become an "unsuspecting party" to deceit perpetrated by the client.

To best negotiate a settlement for taxpayers, the tax lawyer must also learn the background and relevant facts of the dispute. Knowledge of the case is critical before deciding how to best advocate the taxpayer's position. Most cases involve factual discovery and such analysis is often overlooked or dismissed by taxpayers as costly or unnecessary.

3. Burden of Proof in Tax Disputes

3.1 General Comments

A tax lawyer must always keep in mind that the burden of proof in judicial proceedings is normally on the taxpayer. Although it is Canada Revenue Agency's duty to communicate to the taxpayer the precise facts and assumptions upon which it has relied to raise an assessment, these facts and assumptions are presumed to be correct. The taxpayer must raise doubt as to their accuracy. It is only in a situation where Canada Revenue Agency has not discharged its duty, that the burden of proof may shift from the taxpayer to Canada Revenue Agency. Generally, the burden of proof has been placed upon the taxpayer because the taxpayer is in command of the facts. For an excellent review of the law, see Innes and Moorthy, "Onus of Proof and Ministerial Assumptions: The Role and Evolution of Burden of Proof in Income Tax Appeals" (1998) C.T.J. 1187.

Success in tax litigation will depend ultimately on the ability of the taxpayer to shift the burden of proof by demolishing all of the assumptions made by the Minister in raising the assessment. However, in practice, Canada Revenue Agency is not always clear about the assumptions upon which the assessment is made and in fact assumptions change throughout the tax dispute resolution process commencing during the audit all the way through to Tax Court. This section of the paper briefly analyzes some issues that arise dealing with the burden of persuasion facing the taxpayer in Tax Court proceedings.

3.2 Overview of the Law

Johnston v. MNR 3 D.T.C. 1182 (S.C.C.) is often cited for the proposition that in a tax appeal, the taxpayer bears the burden of proof. While this statement is true, it also incomplete. Some recent case law highlights circumstances in which the taxpayer may shift that burden to the Minister. Shifting the burden may assist in the taxpayer successfully winning the appeal.

The *Johnston* decision is an extension of the statutory presumption contained in subsection 152(8) that an assessment is deemed to be valid. *Johnston* extended this statutory presumption in two ways. First, every fact assumed by the Minister in raising the assessment has to be accepted by the Court unless challenged by the taxpayer. Second, the Minister must disclose to the

taxpayer the findings of fact and legal rulings on which the assessment is based. This latter obligation is often fulfilled in the Minister's Reply to a Notice of Appeal.

Based on principle on the decision of *MNR v. Pillsbury Holdings Ltd.* 64 D.T.C. 5158 (Ex. Ct.), the taxpayer may discharge the burden of proof in three ways. At page 5188, Mr. Justice Cattanach explained that the taxpayer may discharge the burden by:

(a) "challenging the Minister's allegation that he did assume those facts,

(b) assuming the onus of showing that one or more of the assumptions was wrong, or

(c) contending that, even if the assumptions were justified, they do not of themselves support the assessment."

Mr. Justice Cattanach went on to state the following comments, which although, obiter dicta, still serves as an expression of the law:

> "The Minister could, of course, as an alternative to relying on the facts he found or assumed in assessing the respondent, have alleged by his Notice of Appeal further or other facts that would support or help in supporting the assessment. If he had alleged such further or other facts, the onus would presumably have been on him to establish them. In any event, the Minister did not choose such alternative in this case and relied on the facts that he had assumed at the time of the assessment."

The taxpayer does not bear the burden of proof with respect to the imposition of penalties. In *Dymond v. MNR* 90 D.T.C. 1920 (T.C.C.), the Court held that where the imposition of penalties is the only issue, then the Minister must lead evidence first. However, where the taxpayer is challenging the assessment as well as the penalties, then the taxpayer is the first to go forward (*The Queen v. W. Taylor* 84 D.T.C. 6459 (F.C.T.D.)).

In *Hickman Motors* 97 D.T.C. 5363 (S.C.C.) at 5377, the Supreme Court of Canada expressed its view regarding the methodology of "demolishing assumptions".

Onus of Proof

> "... As I have noted, the appellant adduced clear, uncontradicted evidence while the respondent did not adduce any evidence whatsoever. In my view, the law on that point is well settled, and the respondent failed to discharge its burden of proof for the following reasons.
>
> It is trite law that in taxation the standard of proof is the civil balance of probabilities: *Dobieco v. MNR*, [1966] S.C.R. 95, and that within balance of probabilities, there can be varying degrees of proof required in order to discharge the onus, depending on the subject matter: *Continental Insurance v. Dalton Cartage*, [1982] 1

S.C.R. 164; *Pallan v. MNR*, 90 D.T.C. 1102 (T.C.C.) at p. 1106. The Minister, in making assessments, proceeds on assumptions *(Bayridge Estates v. MNR,* 59 D.T.C. 1098 (Ex. Ct.), at p. 1101) and the initial onus is on the taxpayer to "demolish" the Minister's assumptions in the assessment *(Johnston v. MNR,* [1948] S.C.R. 486; *Kennedy v. MNR*, 73 D.T.C. 5359 (F.C.A.), at p. 5361). The initial burden is only to "demolish" the exact assumptions made by the Minister *but no more* (*First Fund Genesis v. The Queen*, 90 D.T.C. 6337 (F.C.T.D.), at p. 6340).

This initial onus of "demolishing" the Minister's exact assumptions is met where the appellant makes out at least a *prima facie* case: *Kamin v. MNR,* 93 D.T.C. 62 (T.C.C.); *Goodwyn v. MNR*, 82 D.T.C. 1679 (T.R.B.). In the cases at bar the appellant adduced evidence which met not only a *prima facie* standard, but also, in my view, the appellant "demolished" the following assumptions as follows: a) the assumption of "two businesses", by adducing clear evidence of only one business; (b) the assumption of "no income", by adducing clear evidence of income. The law is settled that unchallenged and uncontradicted evidence "demolishes" the Minister's assumptions: see for example *MacIsaac v. MNR,* 74 D.T.C. 6380 (F.C.A.), at p. 6381; *Zink v. MNR*, 87 D.T.C. 652 (T.C.C.). As stated above, all of the appellant's evidence in the case at bar remained unchallenged and uncontradicted. Accordingly, in my view, the assumptions of "two businesses" and "no income" have been "demolished" by the appellant.

Where the Minister's assumptions have been "demolished" by the appellant, *"the onus shifts to the Minister to rebut the prima facie case"* made out by the appellant and to prove the assumptions: *Maglib Development Corp. v. The Queen*, 87 D.T.C. 5012 (F.C.T.D.), at p. 5018. Hence, in the case at bar, the onus has shifted to the Minister to prove its assumptions that there are "two businesses" and "no income".

Where the burden has shifted to the Minister and the Minister adduces no evidence whatsoever, the taxpayer is entitled to succeed: see for example *MacIsaac*, *supra*, where the Federal Court of Appeal set aside the judgement of the Trial Division, on the grounds that (at pp. 6381-2) the "evidence was not challenged or contradicted and no objection of any kind was taken thereto". See also *Waxstein v. MNR*, 80 D.T.C. 1348 (T.R.B.); *Roselawn Investments Ltd. v. MNR*, 80 D.T.C. 1271 (T.R.B.). Refer also to *Zink v. MNR, supra*, at p. 653, where, even if the evidence contained "gaps in logic, chronology and substance", the taxpayer's appeal was allowed as the Minister failed to present any

evidence as to the source of income. I note that, in the case at bar, the evidence contains no such "gaps". Therefore, in the case at bar, since the Minister adduced no evidence whatsoever, and no question of credibility was ever raised by anyone, the appellant is entitled to succeed.

In the present case, without any evidence, both the Trial Division and the Court of Appeal purported to transform the Minister's unsubstantiated and unproven assumptions into "factual findings", thus making errors of law on the onus of proof. My colleague Iacobucci, J. defers to these so-called "concurrent findings" of the courts below, but, while I fully agree in general with the principle of deference, in this case two wrongs cannot make a right. Even with "concurrent findings", unchallenged and uncontradicted evidence positively rebuts the Minister's assumptions: *MacIsaac, supra*. As Rip, T.C.J., stated in *Gelber v. MNR*, 91 D.T.C. 1030, at p. 1033, "[the Minister] is not the arbiter of what is right or wrong in tax law". As Brulé, T.C.J., stated in *Kamin, supra*, at p. 64:

> the Minister should be able to rebut such *[prima facie]* evidence and bring forth some foundation for his assumptions.
>
> …
>
> The Minister does not have a *carte blanche* in terms of setting out any assumption which suits his convenience. *On being challenged by evidence in chief he must be expected to present something more concrete than a simple assumption*.
>
> [Emphasis added.]

In my view, the above statement is apposite in the present case: the respondent, on being challenged by evidence in chief, failed to present anything more concrete than simple assumptions and failed to bring forth any foundation. The respondent chose not to rebut any of the appellant's evidence. Accordingly, the respondent failed to discharge her onus of proof.

I note that, in upholding the Minister's unproven assumptions, my colleague Iacobucci, J. may be seen as reversing the above-stated line of caselaw, without explicitly providing the rationale for doing so. With respect for the contrary opinion, in my view, changes in the jurisprudence regarding the onus of proof in tax law should be left for another day. Furthermore, on the facts of the case at bar, sanctioning the respondent's total lack of evidence could seem

> unreasonable and perhaps even unjust, given that the appellant complied with a well-established line of jurisprudence as regards its onus of proof."

3.3 Assumptions Raised at the Appeals Stage

As a result of *Anchor Pointe*, the Crown may now raise assumptions of fact (which the taxpayer must disprove) at the initial appeals stage. In *Anchor Pointe*, predecessors of the Applicant deducted the purchase price of seismic data from their incomes as Canadian Exploration Expenses. In their 1991 tax returns, the Minister reassessed the Applicant and reduced each deduction on the basis that only the fair market value of the data could be claimed. The Applicant objected. After the expiration of the normal reassessment period for the Applicant's 1991 taxation year, the Minister issued notices confirming the assessment and, for the first time raised a new position that the expenses do not qualify as Canadian Exploration Expenses. The Applicant put the following question to the Tax Court of Canada, on consent: "Who bears the onus of proof with respect to assumptions of fact first relied on by the Minister of National Revenue in confirming a reassessment pursuant to subsection 165(3) of the Income Tax Act?"

The Federal Court of Appeal, in allowing the Minister's appeal, considered the powers of the Minister after an objection and found that the Minister may make assumptions, and that such assumptions may be pleaded. The Court then turned to the definition of "assessment".

In the case law there were two competing lines of authority. The first stood for the principle that an assessment is the process of assessing and includes confirmation. The second established that the Act does not use the term "process of assessing tax liability" and, accordingly, an assessment does not include a confirmation, as that is a separate and distinct act by the Minister. The Court preferred the first line of authorities, and distinguished the second line of authorities on the basis that it had not addressed the burden of proof.

The Court concluded that at either the assessment or objection stage, the Minister is attempting to determine the taxpayer's tax liability and the quantum thereof. An assessment includes confirmation, and the taxpayer bears the burden of disproving assumptions made upon confirmation.

Whatever the case, tax counsel must still be vigilant to ensure that Tax Court judges carefully consider the suitability of the contents of Replies filed by the Crown in the appropriate circumstances. Otherwise, taxpayers may have to rebut inappropriate assumptions or new bases for assessment which were otherwise statute-barred.

3.4 Provincial Court View of Onus of Proof

In 2010, the BC Court of Appeal commented extensively on the onus of proof in tax appeals. In *Northland Properties*, Huddart, J.A. stated the following:

> [10] The important point is that there are two legal burdens in a tax assessment appeal: the initial legal burden on the taxpayer to prove that the Minister's assumptions are incorrect, and, if the taxpayer is successful, the conditional legal burden on the Crown

> to show that the assessment as a whole is nevertheless valid: *Anderson Logging Company v. The King* (1924), [1925] S.C.R. 45; *Johnston v. M.N.R.*, [1948] S.C.R. 486; *M.N.R. v. Pillsbury Holdings Ltd*. (1964), 64 D.T.C. 5184 (Ex. Ct.); *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336; and, most recently, *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, [2006] 1 S.C.R. 715. The burdens do not "shift" halfway through the proceedings, but are related and linked burdens each borne by one of the parties.
>
> [35] In summary form, the proper approach on the appeal of a tax assessment may be described thus:
>
> i. What are the assumptions?
>
> ii. Have some or all of the assumptions been disproven? (i.e. has the taxpayer discharged the initial legal burden?)
>
> iii. If the taxpayer has successfully discharged the initial legal burden, then has the Crown shown that the assessment is valid? (i.e., has the Crown discharged the conditional legal burden?)

4. The Importance of Good Pleadings in Tax Court Proceedings

4.1 Introduction

Some readers may think that the drafting of legal pleadings is preoccupied with the arcane and involves the recitation of mystical chants and incantations uttered by the high priests of law. However, the practical consequences of poor pleadings should not be lost on anyone. The proper presentation of pleadings by either party in Tax Court proceedings may assist in ultimate success.

A taxpayer files a Notice of Appeal in the Tax Court of Canada to initiate an appeal to challenge the merits of assessments or reassessments raised by the Minister of National Revenue (the "Minister"). The Crown will file a defence known as a "Reply" to the Notice of Appeal filed by the taxpayer. The Reply will contain responses to the positions set out by the taxpayer in the Notice of Appeal and will also set out the assumptions upon which the assessment or reassessment was based.

The content of pleadings in tax litigation is important. The pleadings define the facts and issues in dispute and also set out the appropriate remedies sought by the taxpayer. If pleadings are not drafted in a precise manner with care, then litigation proceedings can be prolonged which in turn results in wasted time and costs. Therefore it is critical for counsel for both the taxpayer and the Crown to make efforts to accurately draft the pleadings in a fashion which defines the facts and issues in dispute.

As part of efforts to win a tax appeal, taxpayers may attack the Crown's pleadings either before the commencement of the hearing of the tax appeal (through motions brought before the Tax Court) or alternatively during the course of the appeal. Grounds for attacking the Crown's pleading include challenging the Minister's assumptions because they were never raised or assumed by the Minister or because the pleadings are vague or because they contain untrue facts. These issues have been canvassed quite well in a recent article by Bill Innis, "Will-o'-the-Wisps and Other Exotic Tax Species: Recent Developments in the Rules of Crown Pleading in Tax Litigation" Tax Litigation Vol. XI, No. 2 682-694. Yet, it is not only taxpayers who want to win. Sometimes, the Crown may attempt to change its plan of attack and "raise a new basis for assessment" or "new arguments" to support the assessment in litigation proceedings before the Tax Court of Canada. Whether the Crown is permitted to do so will depend on the time when it is done. As discussed above, the *Act* permits raising a new basis of assessment before the expiry of statutory limitations periods (s. 152(4)) and new arguments to support an existing assessment either before or after this time (s. 152(9)). Prejudice is always a factor which has an impact on amendments to pleadings. For example, see *Potash Corporation of Saskatchewan Inc. v. The Queen* 2004 D.T.C. 6002 (F.C.A.).

On April 6, 2004, the Federal Court of Appeal released its decision in *The Queen v. Loewen* 2004 D.T.C. 6321, leave to the S.C.C. denied (December 9, 2004). This decision is an important one because it articulates what the Crown can and cannot do in drafting its pleadings (replies) in Tax Court of Canada proceedings. The *Loewen* decision is the most recent pronouncement from the Federal Court of Appeal regarding the possibility of attacking Crown pleadings and seems to clarify the extent to which taxpayers should or should not waste precious resources by attempting to challenge new grounds of attack raised by the Crown at various points in the litigation process. Before summarizing the findings of the Federal Court of Appeal, it is appropriate to set out briefly the facts in *Loewen*.

The taxpayer claimed a full deduction for capital cost allowance for the 1993 and 1994 taxation years in respect of software which he had acquired in 1993. The assessments raised against the taxpayer indicated that there were two issues underlying the assessments: valuation and the software's availability for use. The taxpayer filed Notices of Objection to the reassessments and failing a reply from the Minister proceeded directly to appeal the reassessments to the Tax Court of Canada. In its reply, the Crown presented four defences of the reassessments, three of which related to the cost to the taxpayer of his interest in the software as determined for income tax purposes. The fourth defence resulted in the taxpayer having no right to claim CCA at all whereas the first three limited his claims for capital cost allowance to his cost.

The taxpayer brought a motion before Associate Chief Justice Bowman of the Tax Court of Canada to allow his appeals on the basis that the Crown had pleaded assumptions that did not form part of the assessment process, or, in the alternative, to strike out the Crown's reply without leave to re-file or in the further alternative to delete the offending portions of the reply. The Tax Court of Canada determined that the reply should not be struck out in its entirety. Even though the Court found that certain pleadings by the Crown were inaccurate regarding the assumptions made by the auditor, the Court determined that the taxpayer was best to serve a Notice to Admit rather than to cause the pleadings to be gutted. However the Tax Court did strike out certain portions of the reply which it considered amounted to a "new basis for assessment". After admonishing the Crown regarding its use of "weasel words", Associate Chief Justice Bowman

indicated that counsel for taxpayers should litigate their cases and avoid procedural wrangles prior to the hearing of the appeal.

A unanimous decision of the Federal Court of Appeal reversed the findings of Associate Chief Justice Bowman which had struck out parts of the reply filed by the Crown in defending the reassessments. In speaking for the majority, Madame Justice Sharlow articulated a series of legal principles about assessments and the pleading of cases in the Tax Court of Canada. Some of the comments will not surprise while others may seem more controversial. However, the judgment signals the Federal Court of Appeal's agreement with Associate Chief Justice Bowman that taxpayers may challenge inappropriate or incorrect assumptions made by the Crown in its pleadings within certain limits. The best way to highlight the findings of the Federal Court of Appeal is to break down Madame Justice Sharlow's comments into two sections; the first deals with general principles about pleadings and the second with how the Crown may draft its reply.

4.2 General Principles about Pleadings, Evidence and Assessments

- An assessment is the determination by the Minister of the amount of a person's tax liability and the basis of any assessment is a matter of historical fact and does not change. The basis of a reassessment normally includes the facts relating to the increased taxable income as the Minister perceives those facts when the reassessment was made. The basis of the reassessment also includes the manner in which the Minister applied the facts to the relevant law when making the reassessment and any conclusions of law which guided the application of the facts to the law.

- It is only the taxpayer and not the Crown that has the right to appeal an income tax assessment.

- A Notice of Appeal in the Tax Court must state the facts and arguments upon which the appellant relies to establish that the assessment is incorrect.

- The Reply filed by the Crown must state the Crown's position with respect to each factual allegation and argument in the Notice of Appeal and also states the facts and arguments upon which the Crown relies to defend the correctness of the assessment.

- For each fact alleged in the Notice of Appeal, the Reply must indicate that the Crown admits a fact, denies it or has no knowledge of it. The Reply should also state the factual assumptions upon which the assessment under appeal is based.

- The Minister's factual assumptions stated in the Reply are taken as fact unless they are disproved or it is established that the Minister did not make the assumptions that are said to have been made.

- It is the taxpayer who has the onus to prove that the Minister's assumptions are not true or that they were not made. In addition, the taxpayer may attempt to establish by argument that the facts assumed do not justify the assessment as a

matter of law even if such facts are true. The Minister will bear the onus of proof for those assumptions/facts not made which are necessary to support the assessment.

- The scope of the evidence presented in the Tax Court is itself limited by the pleadings.

4.3 How the Crown may Draft its Reply

- The Crown must ensure that the "assumptions paragraph" in its Reply is clear and accurate.

- The Crown cannot make inconsistent assumptions in the Reply at the same time.

- The Crown may not plead in its Reply that the Minister made a certain assumption when making the assessment if in fact the assumption was not made until later (when the Minister confirmed the assessment following the Notice of Objection).

- The Minister may plead that the Minister assumed something was not assumed when the assessment was first made. This may be done when confirming an assessment.

- The Minister may assert elsewhere in the Reply those factual allegations and legal arguments which are not consistent with the basis of assessment. However, the onus of proof lies with the Crown if the Crown alleges a fact that is not among those assumed by the Minister.

- The Crown may introduce new legal arguments to the extent that they are consequential on the facts alleged in the pleadings, including the Notice of Appeal, the assumptions in the Reply and any additional facts alleged in the Reply.

- New legal arguments are permitted if they arise from the evidence presented in the Tax Court proceedings.

- The expiration of the normal reassessment period does not preclude the Crown from defending an assessment on any ground.

- Subsection 152(9) permits the Crown to present alternative arguments in support of an assessment after the expiry of normal limitations periods.

- A new argument asserted by the Crown could include an argument that would justify an assessment that exceeds the amount assessed. However, the Minister cannot use a subsection 152(9) argument to reassess outside the time limitations in subsection 152(4) or to collect tax exceeding the amount in the assessment under appeal. The Crown may, however, present a new argument either at the

conclusion of the objection stage or for the first time at the pleading stage, even if it is asserted for the first time after the expiry of the time limit for reassessments.

- There are occasions where it is appropriate to use words such as "so called", "called a", "purported" and "alleged". This could be done where the Crown does not wish to admit an allegation of the taxpayer. However there are occasions when the use of such words is not appropriate; for example, if one of the factual assumptions made by the Minister when assessing had been the existence of a legal relationship.

- The Crown may defend an assessment on the basis of an argument the taxpayer believes was resolved by the Minister in the taxpayer's favour before the assessment was made or confirmed.

4.4 Increased Procedural Disputes

At one time it was thought that pre-hearing motions about the content of pleadings may diminish as a result of some of the comments in the *Loewen* decision. However, this has not occurred. Procedural disputes have increased. See Kroft, "Procedural Disputes" 2007 CTF Annual Conference Chapter 7. Cases such as *Status-One Investments* 2004 D.T.C. 3042, affirmed 2005 D.T.C. 5224 (F.C.A.), *Gould* 2005 D.T.C. 1311 and *Anchor Pointe* 2006 D.T.C. 3365, reversed 2007 D.T.C. 5379 (F.C.A.), SCC leave denied on January 17, 2008, affirm that conflict about the contents of pleadings is continuing.

5. Quest for a "Legal" Settlement

Resolving tax disputes is sometimes unlike resolving civil disputes. In civil disputes, the parties are often amenable to settlement on practical grounds. For example, parties may agree to "split the difference" and not ultimately resolve the legal issues at the heart of their dispute. This may not be the case in tax litigation. Canada Revenue Agency will not generally settle without a basis in the *Act* for the settlement. In fact, it is not even within Canada Revenue Agency's power to settle on a basis that is not within the *Act* as stated in the following extract from *In Re Galway v. MNR* 74 D.T.C. 6357 (F.C.A.):

> "In our view, the Minister has a statutory duty to assess the amount of tax payable on the facts as he finds them in accordance with the laws as he understands it. It follows that he cannot assess for some amount designed to implement a compromise settlement... "

This extract was cited with approval in the decision of *Cohen v. The Queen* 80 D.T.C. 6250 (F.C.A.). See also *Harris v. The Queen* 2000 D.T.C. 6373 (F.C.A.). Given this restriction and the parameters of the *Financial Administration Act*, it is necessary to be creative within the law to craft a resolution acceptable to both sides. The "Fairness Package" discussed below may assist in this regard. Settlement is an art and not a science and involves many factors and considerations. For a detailed discussion, see Kroft, "Settlement Strategies in Tax Disputes" (2001) *Prairie Provinces Tax Conference Report* (Canadian Tax Foundation) and Sandler and

Campbell "Catch 22 – A Principaled Basis for the Settlement of Tax Appeals" (2009) Canadian Tax Journal 762-86.

6. Accessing Information from Tax Authorities

6.1 Informal Requests

There is nothing wrong with asking a tax official for a document which is relevant to the civil assessment or criminal prosecution of a taxpayer. Auditors do release relevant information within the parameters of Section 241 of the *Act*. This approach is consistent with Department policy as stated at the 1988 Corporate Management Tax Conference:

> "The access and privacy legislation has not altered the department's longstanding practice of granting informal access. Public policy in this area has been entrenched in the Declaration of Taxpayer Rights as it related to fair treatment of taxpayers in all dealings with Canada Revenue Agency, Taxation. Specifically, taxpayers are entitled to expect that the government will make every reasonable effort to provide taxpayers with access to full, accurate, and timely information about the *Income Tax Act* and the taxpayer's rights under it. The privacy and confidentiality paragraphs of the Declaration of Taxpayer Rights reinforce the confidentiality of information requirements.
>
> Tax practitioners should be aware that a significant amount of information is available informally, such as copies of returns and financial statements, and quite often the auditor's report and supporting working papers, but only when the integrity of the confidentiality provision of the *Act* can be assured. Other examples of information disclosed informally include head office referrals and technical opinions, and real estate appraisal reports."

Each District Office apparently has a system whereby information may be obtained informally rather than through formal channels. Designated persons from each work area act as contacts through which the public can make such informal requests. It is common to request T20 Auditor Reports, T401 Appeals Reports and Valuation Reports through such sources.

6.2 Formal Access And Disclosure Before Judicial Proceedings

Tax officials concerned about Section 241 of the *Act* often encourage taxpayers to obtain information under the *Privacy Act* or the *Access To Information Act*. Each statute serves a different function but both involve the use of Info Source, a book and computer database, as the means through which information can be obtained.

6.3 *The Access To Information Act* ("ATI Act") and *Privacy Act* – General Comments

The *ATI Act* gives Canadian citizens as well as people and corporations present in Canada the right to have access to information in federal government records. The *Privacy Act* gives

Canadian citizens and people present in Canada the right to have access to information held about them by the Federal Government. This statute also protects against the unauthorized disclosure of personal information and details the means whereby government collects, uses and stores it.

Tax practitioners must learn how to utilize these statutes which serve as the primary means of obtaining significant information from tax authorities, before the commencement of judicial proceedings. A comparison of the structure of both statutes reveals a strong resemblance. However, there are differences between each. Generally speaking, these distinctions are not all that fundamental for purposes of the following discussion. However, as the paper will indicate, there are subtle distinctions between the use of each of these statutes which the tax practitioner must come to appreciate in utilizing them effectively. This section of the paper contains a practical overview of these statutes and outlines means within which to utilize them.

6.4 When Should or Can One Use the *Privacy Act* or the *ATI Act*?

An individual must use the *Privacy Act* to obtain information about himself or herself. Therefore practitioners who act on behalf of an individual will either cause that individual taxpayer to apply to obtain a release of information or will apply on behalf of that particular individual together with the appropriate consent to disclose the information to the practitioner. The *ATI Act* is available to taxpayers who are corporations or to any taxpayer, individual or a corporation, who wishes to obtain information about Canada Revenue Agency practices and procedures, information generated by the Department of Finance or perhaps even the Department of Justice in limited circumstances. The tax practitioner seeking to use the *ATI Act* and to obtain information about a client must obtain a consent from that client to disclose the information to the practitioner. This consent is then mailed with the form seeking the information to the appropriate government representative.

6.5 Cost Associated With Applications Under the *Privacy Act* and the *ATI Act*

Privacy Act applications are free. The government does not charge for photocopying disbursements. However the *ATI Act* contemplates an application fee and an hourly rate for searching out the information. Disbursements are also charged to the taxpayers or to the applicant. Photocopy charges are $0.20 per page but are usually waived for less than 125 pages. Generally speaking, these photocopying costs associated with the provision of documents are not that onerous and it is more cost-effective usually for a taxpayer's representative to ask for an entire copy of the file rather than to go and review the file at Canada Revenue Agency offices in a District Office to decide which photocopies to take. Understandably if the entire file of a taxpayer for a number of taxation years is sought then the copying costs might be more significant.

6.6 Is The Information Being Sought Available Or Valuable?

Taxpayers generally seek the following documents in the course of making either a *Privacy Act* application or an *ATI Act* application:

- auditors reports (T20);

- auditors working papers;
- information or documents supplied by third parties;
- information or documents supplied by the taxpayer;
- appeals officers report (T401);
- notes of meetings and conversations with Canada Revenue Agency personnel (T2020);
- technical Canada Revenue Agency interpretations;
- Canada Revenue Agency internal memoranda;
- special investigation reports and documents;
- tax avoidance position papers and internal memoranda;
- Department of Justice opinions;
- Department of Finance backup materials and memoranda;
- foreign government investigation reports.

One can only judge from the preceding list how valuable obtaining the above information might be. Generally speaking, a taxpayer wishes to refute any assessment or reassessment raised by tax authorities as quickly and as cost-effectively as possible. To make a rational decision about the pursuit of tax litigation and to properly evaluate chances of success, a taxpayer usually prefers to possess as much information as possible to make this decision. To the extent that the representatives can properly ascertain the strength of Canada Revenue Agency's position or can evaluate the degree of flexibility within which Canada Revenue Agency may be prepared to settle a particular case, then the above information might prove very valuable.

Whether the information being sought is available, however, is another question. There are a variety of exceptions contained within both the *Privacy Act* and the *ATI Act* which might prohibit the disclosure of information. The *ATI Act* incorporates Section 241 of the *Act* by reference. Generally speaking the following are the most common reasons why information is denied under these Sections:

- information is obtained in confidence from non-federal government sources;
- information would adversely affect federal-provincial affairs;
- information would adversely affect a third party;
- information pertains to the operations of government;

- information was obtained and prepared for the purpose of law enforcement and investigation;

- information is subject to solicitor-client privilege;

- it is "personal information".

Quite commonly materials obtained through the *Privacy Act* and the *ATI Act* come back severed or completely obliterated. In their place are pages with references to various Sections within the applicable legislation. Some of the documents described above may not be obtainable for some other reasons that have been already outlined. Nevertheless, this often might prove to be a debatable point. An appeal might be brought before the Information Commissioner to obtain the further release of documents withheld for one of the reasons described earlier. Note that there are strict limitation periods for making this complaint. Further recourse to contest the denial of information may be taken in the Federal Court. See, for example, Coastal Resources Ltd. v. M.N.R. 2009 F.C. (Heneghan, J.J. regarding attempts to get non-redacted CRA internal memoranda.

6.7 How Long Will The Process Take and How Will It Affect The Appeal Process?

One must carefully consider the timing of the *Privacy Act* or *ATI Act* request. Notwithstanding certain statutory protections, it might take a minimum of three months and perhaps a year (or longer) to obtain copies of the materials sought. The length of time will vary with the scope of the request and the need to sever information from the files. *Privacy Act* and *ATI Act* requests generally delay the prosecution of an appeal where the files are physically taken away from the parties who are working upon them. To the extent that a file has already progressed to the point where pleadings are to be filed, then it may be appropriate to delay making a request under either of the applicable statutes in anticipation of receiving the documents through the discovery process, if they will in fact become available. More commonly, taxpayers should make their requests as quickly as possible to obtain as much information about the basis upon which the Minister has reassessed the taxpayer. Canada Revenue Agency takes the position, however, that documents cannot be obtained through the *ATI Act* or *Privacy Act* processes prior to the completion of an audit. This position is debatable and, apparently has not yet been resolved through litigation. One should still consider making a request to the extent that one wishes to ascertain the progress of an audit or to obtain copies of documentation or internal memoranda that the auditor will not provide.

6.8 Will The Information Become Available In Any Event?

Information available through the *ATI Act* or *Privacy Act* will often become available on discoveries subject to solicitor-client or Crown privilege. Therefore information derived from third parties that might not otherwise become accessible through the statutory processes described can be disclosed free of the restrictions of Section 241 of the *Act*. Given the scope of the Federal Court rules relating to discoveries and production of documents there is a greater chance of disclosure of this information than there may have been previously. The wording found in the Tax Court Rules is not as broad. Therefore some Canada Revenue Agency documentation and explanatory notes prepared by the Department of Finance may not be

available for disclosure through the discovery process. Given this dynamic, it is still preferable to make *ATI Act* and *Privacy Act* requests prior to the discovery process in the event one is uncertain whether the information will become available through discoveries. Such information might also be valuable for purposes of discovering an assessor or other relevant party regarding the assumptions of fact and law relied upon by the Minister in raising a particular assessment or reassessment.

6.9 How Do You Make Applications Under the *Privacy Act* or the *ATI Act*?

(a) Info Source

The process is quite simple. As mentioned earlier, to the extent that consents of particular parties are required then they must be sent in together with the application form and any fees. It is no longer necessary for an applicant to disclose the various government data bases within which information is being sought. The Treasury Board Secretariat has developed a single data base capable of producing a variety of publications known as Info Source. This document is valuable insofar as it explains how to exercise rights under both the *ATI Act* and *Privacy Act*. This text has replaced the old Access Register and the Index to Personal Information books. It is also available in an on-line computer database format.

(b) *ATI Act* Application

Once a taxpayer has decided to make a formal request under the *ATI Act* the following procedures must be followed:

- decide which department or agency has the information required (Department of Justice, Canada Revenue Agency, Department of Finance);
- send either a signed letter saying you are requesting information under the *ATI Act* or a completed Access to Information request form to that particular agency or department which apparently has the information; and
- include an application fee of $5.00 for each request. Additional costs may be charged and taxpayers are notified in advance of additional costs. Sometimes taxpayers are asked to make a deposit of funds in the event that costs are expected to be significant.

(c) *Privacy Act* Application

To make an application for personal information under the *Privacy Act* a taxpayer (or his or her representative) must:

- fill out an application form;
- identify oneself in such a way that the government can verify that it is the taxpayer and not someone else asking for the information. To the extent that someone else is asking for that information the consent of the taxpayer must be provided; and

- send the form to the Privacy Coordinator of the department or agency you think has the information. As mentioned earlier, there is no cost to process a request made under the *Privacy Act* or to seek the help of the Privacy Commissioner.

6.10 What Goes Into An Application?

A taxpayer's representative should outline in very broad terms the information that is being sought. For example if one wishes a copy of the auditor's report, the appeals officer's report, any records of notes or conversations relating to these documents or any internal memoranda then the application must be as precise as possible. If documentation is located in the taxpayer's T2 return or in the tax return file then one might also request a copy of the return together with all related annotations. Obviously the broader request the more expensive the process will likely become if it is brought under the *ATI Act*.

6.11 Some Practical Tips and Traps

- If an appeal involves a variety of related taxpayers then get the consent to disclose information from these related taxpayers before the application is sent in. Otherwise Canada Revenue Agency will sever out all the information dealing with this related party even though the assessment may depend upon conversations, discussions or intentions of this related party. These comments are not limited to consents from related parties. For example in a transaction involving two arm's length parties, one party might wish to obtain the consent of the other to have Canada Revenue Agency disclose information about that other party. This consent is valuable so that the documents provided by Canada Revenue Agency may be complete and readable. Otherwise, the documents may be so severed, given Canada Revenue Agency's need to comply with Section 241 of the *Act*, that they will become difficult to read. It might then be more difficult to discern the intention of the Minister by raising the reassessment.

- Try to obtain consents for disclosure from third parties who might have been involved in a transaction. This may include financial institutions or arm's length taxpayers in addition to related taxpayers.

- Try to narrow the scope of the *ATI Act* application in order to expedite its processing.

- There are circumstances in which information may not be contained within the taxpayer's regular file. For example, in a transaction involving scientific research and experimental development ("SRED") and investment tax credits, Canada Revenue Agency may keep a separate scientific file which may contain information regarding the qualification of the research performed by the taxpayer as SRED (as defined in the Regulations to the *Act*). This information would not normally form part of the information sent under an *ATI Act* request unless it was expressly requested by the taxpayer or the representative.

- Do not hesitate to make complaints to the Information Commissioner about the lack of information provided by Canada Revenue Agency particularly in circumstances when it is denied because of Canada Revenue Agency's assertion that the information was gathered for the purposes of law enforcement.

- Try to obtain information through an informal access request. If you do not ask the appeals officer for the information first then you might be costing your client time and money. Point out to the officer that these documents will be available through the discovery process anyway at a later point in time and it will expedite the handling of the file if these documents are now provided.

7. Knowledge of Tax Personnel and the Canada Revenue Agency

Taxpayers expect that tax professionals will know whom to talk to about how to solve problems and what processes government officials follow when conducting audits or making decisions to reassess taxpayers. The paper will later describe issues which arise when dealing with the audit, internal appeals and collections divisions of the Canada Revenue Agency.

7.1 Structure and Management of the Canada Revenue Agency

On April 29, 1999, Parliament passed the *Canada Customs and Revenue Agency Act*, which established the Canada Customs and Revenue Agency (now the Canada Revenue Agency). The change in status from department to agency, which took place on November 1, 1999, was done to "build a modern organization committed to leadership, innovation, and client service".

On December 12, 2003 the government announced the creation of the Canada Border Services Agency (CBSA), which is responsible for Canada's customs' operations. Two years later, on December 12, 2005, legislation came into effect to legally change the Agency's name to Canada Revenue Agency (CRA).

The CRA is responsible for the administration of tax programs, as well as the delivery of economic and social benefits. It also administers certain provincial and territorial tax programs. In addition, the CRA has the authority to enter into new partnerships with the provinces, territories, and other government bodies to administer non-harmonized taxes and other services, at their request and on a cost-recovery basis.

7.2 Role of the Minister of National Revenue

The Minister of National Revenue is accountable to Parliament for all the CRA's activities, including the administration and enforcement of the *Act* and the *Excise Tax Act*. The Minister must ensure that the CRA operates within the overall government framework and consistently treats its clients with fairness and integrity.

7.3 Role of the Board of Management

The Board of Management consists of 15 members appointed by the Governor in Council. Eleven of these members have been nominated by the provinces and territories. The Board has the responsibility of overseeing the organization and management of the CRA, including the

development of the Corporate Business Plan, and the management of policies related to resources, services, property and personnel.

The CRA's Board of Management is not involved in all the CRA's business activities. It does not have the authority to administer and enforce legislation or to access confidential client information.

7.4 Role of the Commissioner - Chief Executive Officer

As the CRA's chief executive officer, the Commissioner is responsible for the day-to-day administration and enforcement of program legislation that falls under the Minister's delegated authority. The Commissioner is accountable to the Board of Management for the daily management of the CRA, supervision of employees, and implementation of policies and budgets.

Moreover, the Commissioner must assist and advise the Minister with respect to legislated authorities, duties, functions, and Cabinet responsibilities.

7.5 The Role of the Chair

As the presiding director of the Board of Management, the Chair manages the affairs and functioning of the Board and guides the Board to ensure it meets its responsibilities.

7.6 The Taxpayer Bill of Rights

The Taxpayer Bill of Rights is a set of fifteen rights confirming that the Canada Revenue Agency (CRA) will serve taxpayers with a high degree of accuracy, professionalism, courteousness and fairness. The Taxpayer Bill of Rights will make it easier for taxpayers to understand what they can expect in dealings with CRA; that taxpayers will be treated fairly under clear and established rules, and that they can look forward to high standards of service in all interactions with CRA.

The Taxpayer Bill of Rights also includes the CRA Commitment to Small Business, a five-part statement through which the CRA undertakes to support the competitiveness of the Canadian business community by ensuring that interactions with the CRA are as effective and efficient as possible. These commitments complement the Government of Canada's pledge to create a competitive and dynamic business environment in which Canadian businesses will thrive.

The CRA operates on the fundamental belief that taxpayers are more likely to comply with the law if they have the information and other services they need to meet their obligations. While CRA is committed to raising awareness of a taxpayer's obligations, CRA also wants to make sure taxpayers receive all of the entitlements and that taxpayers clearly understand and can exercise their rights.

The CRA has announced that it is committed to respecting taxpayers' rights. If a taxpayer is not satisfied with the service received from the CRA, the taxpayer may lodge a complaint with the CRA - Service Complaints and the taxpayer will be provided with an explanation of findings. If the taxpayer is not satisfied with the outcome of the review, the taxpayer may lodge a complaint with the Taxpayers' Ombudsman, a position yet to be filled.

More information about these two redress initiatives can be obtained by visiting the CRA – Service Complaints and the Taxpayers' Ombudsman pages on the CRA Web site.

View the full text of the Taxpayer Bill of Rights and the Commitment to Small Business, including a description of each right, on the CRA's Taxpayer Bill of Rights page.

7.7 The CRA Fairness Pledge

The Following is taken off the CRA Web site:

"**Our Fairness Pledge**

- Our fairness commitment is based on service that is responsive, consistent, and impartial.
- Our actions must reflect objective yet considerate application of the law.
- We recognize that taxpayers have specific needs and concerns.

Information

- We will give taxpayers information that is accurate and understandable. We will explain the laws in language that is plain and clear. We will provide all our services in English and French and, in some cases, other languages too.

Timeliness

- We will advise taxpayers of the time it will take to provide the requested service. We will strive to meet that time, and we will continually work toward improving our response time.

Consistency

- We will apply laws consistently and equitably. While each situation is unique, we will ensure taxpayers are treated equally under similar circumstances.

Impartial review

- We will provide taxpayers with review processes that are accessible, transparent, and impartial.

Flexibility

- We understand that every taxpayer has specific needs and concerns. We will endeavour to provide relief when circumstances warrant.

Taxpayer support

- We will act in the interests of taxpayers according to our role under the law. We will inform taxpayers of their rights and obligations under the law, and will ensure that they are aware of the credits, benefits, and overpayments available to them.

Accountability

- We recognize that our commitment to being fair requires a continuous effort. We will measure, maintain, and enhance our commitment to fairness. We will report annually to Parliament and the public on our fairness achievements."

8. Use of the Fairness Package/Taxpayer Relief Provisions ("TRP Package")

8.1 Background

The "Fairness Package" was released by the Minister of National Revenue on May 24, 1991. The new name for this initiative is "Taxpayer Relief Provisions." It is now incorporated into the *Act* through a variety of statutory provisions that deal with certain administrative aspects of the *Act*: such as ministerial discretion to issue reassessments and refunds out of time (subsections 152(4.2),(4.3)); objections to assessments (section 165); appeals (subsection 169(1)); extensions of time to object (sections 166.1 and 166.2); ministerial discretion to waive penalties or interest (subsection 220(3.1)); and ministerial discretion to extend time for making an election or to remit an amendment or revocation (Subsections 220(3.2) to (3.7)). The TRP Package is now discussed in Information Circular ("the Circular") 07-1 dated May 31, 2007. Appendix "A" highlights changes to the Circular from three earlier circulars released in 1992.

The TRP Package also symbolizes an attitude that the Minister of National Revenue and CRA are attempting to instil into his employees and officials. This attitude tends to promote taxpayers as "clients" who will be treated in a fair and impartial manner. Therefore some of the effects of the audit and collection practices of Canada Revenue Agency might be offset or mitigated through the application of the TRP Package.

Some of the TRP Package provisions only apply to individuals and testamentary trusts. However, the most significant amendments that will form the basis for discussion in the paper, are applicable to all taxpayers, and may prove to be of assistance to practitioners involved in resolving disputes with Canada Revenue Agency in circumstances where settlement might otherwise seem difficult to achieve.

8.2 Waiver of Penalties and Interest

Subsection 220(3.1) gives the Minister a discretion to waive or cancel all or any portion of any penalty or interest otherwise payable by a taxpayer or a partnership. In 2005-2006, CRA approved about 36,000 fairness requests. About $626 million in penalties and interest were waived. This usually arises when the audit takes a long time, a matter is sent to head office for

review or when files are held in abeyance. The *Act* contains no further guidelines regarding the discretion which the Minister is to exercise. Explanatory notes accompanying subsection 220(3.1) indicate those circumstances in which it might be appropriate for the Minister to exercise discretion. On March 18, 1992 Information Circular 92-2 was released containing such guidelines. It was replaced in May, 2007 by IC 07-1. Part II of this Circular deals with this topic.

The Circular suggests that penalties and interest might be waived or cancelled where they result in circumstances beyond a taxpayer's or employer's control. However, Canada Revenue Agency indicates that it might also cancel or waive interest or penalties because of actions arising primarily through departmental error or processing delays or in circumstances where there is an inability to pay amounts owing.

(a) 10 Year Limitation

Subsection 220(3.1) expressly states that the Minister may only waive or cancel on or before the day that is 10 calendar years after the end of a taxation year of a taxpayer. For a discussion of how to measure the 10-year period, see *Bozzer* 2010 FC 139 (under appeal to the FCA).

(b) Pre-1985 Claims

The decision in *Montgomery v. The Queen* 95 D.T.C. 5032 (F.C.A.) is noteworthy. In that case, the taxpayers applied to the Minister for relief for years which included the 1984 taxation year. The Minister granted relief but not for 1984 on the basis there was no authority for granting relief for that year. The motions judge and the Federal Court of Appeal agreed with the Minister, citing the enacting statute which stated that relief could be granted for 1985 and subsequent taxation years. There is also a remission order passed under the *Financial Administration Act* entitled "Income Tax Refunds Remission Order" in respect of the taxation years 1980 through 1984 applicable to only individuals and testamentary trusts.

8.3 Practical Aspects of the TRP Package

(a) Applications Under the TRP Package

Applications regarding the TRP Package must be made to the applicable originating division in a particular district office that handles the matter. Therefore, for example, waiver of penalties and interest should be directed to the Chief of Collections. Problems with source deductions or directors' liability might be again directed to the Chief of Collections or to the Chief of Source Deductions. Requests for reassessments beyond the normal statutory period should be put to the Chief of Appeals. The Information Circular outlines the particular method for making Fairness Package applications. Generally speaking, a letter should be drafted outlining all of the applicable facts and the reasons why it is "fair" for the appropriate relief to be granted to the taxpayer.

(b) Getting to the Right Settlement?

There are circumstances in which taxpayers are prepared to pay a certain amount of money to Canada Revenue Agency to get rid of a problem. Although they might not agree with the

assessing practices taken by the Minister, they are prepared to pay a certain amount either in addition to or in lieu of professional fees to rid themselves of the headaches and anxiety associated with dealing with the tax department. The mix of taxes, penalties and interest generally does not matter to the taxpayer. Only the overall dollar amount does. Therefore it is suggested that taxpayers attempt to use the TRP Package to cause all or a portion of any penalties or interest to be waived to achieve a settlement both satisfactory to the taxpayer and "rich enough" for the auditors involved. The criteria set out within the Information Circulars are broad enough to justify waiver of penalty and/or interest in a variety of circumstances, particularly if Canada Revenue Agency employees have not been diligent in formulating proposals in an audit or in circumstances where new judicial concepts have given Canada Revenue Agency a basis upon which to assess a transaction that previously was not considered to be the subject of scrutiny. For example, it would be curious to see how many directors' liability cases should be settled in light of the Department's failure to issue proper details about the breakdown of amounts shown on assessments. It will be also interesting to see whether the application of the TRP Package is appropriate in light of the civil disobedience exercised by Canada Revenue Agency employees during the strike in which certain public service employees threatened to assess certain taxpayers based on the letter of the law rather than its spirit. Canada Revenue Agency has indicated in its Information Circular that it will consider waiving penalties and interest as a result of failure by taxpayers to comply with the *Act* based on certain civil disobedience. Imagine if you couldn't get your tax return assessed on a particular day because people were picketing at the Taxation Centre.

Assessments might be resolved or proposed audit adjustments might be circumvented in a similar fashion with the aid of the TRP Package. For example, if a taxpayer is permitted to make an election under subsection 220(3.2) to eliminate possible income inclusion, the tax advisor might also ask the Minister to waive any associated penalties or interest that would result from the making of the amended or revoked election.

(c) The Need for Wisdom in the Exercise of the TRP Package

TRP Package committees meet within the relevant District Offices to consider the appropriate applications. However, there is now an attempt by CRA to centralize all determinations within a particular Tax Services Office (e.g. Victoria). Taxpayers, however, must be concerned that tax officials each have different perceptions about the function and purpose of the TRP Package and that different decisions will be exercised throughout the country based on different fact patterns and criteria. In addition, practitioners should encourage senior tax officials not to delegate decisions that require subjective judgments and life experience to employees below a certain managerial level to enable taxpayers to obtain the benefit of a broader perspective exercised by the senior tax officials who have practised in the tax area for some time. If one looks at the criteria for waiving penalties and interest or accepting amended elections, certain criteria call for the exercise of compassion by Canada Revenue Agency officials. For example, in the event of matrimonial breakdown resulting in a failure by a taxpayer to file a tax return, should the penalty be waived under the TRP Package if the tax return is not filed on time? Different conclusions might be reached about this simple question based on a person's perspective about marriage and the competing interests and priorities that should occur in a person's life in the event of such stress.

8.4 Challenges To Decisions Under The TRP Package

(a) Appeals to the Director of the Taxation Office

An appeal of the first decision of the TRP Committee may be made to the Director of the relevant office. It is important to get a copy of the TRP Committee Report before making representations.

(b) Court Challenge

There have been a number of court challenges to the Minister's decision under the Fairness Package. The standard to be met must be "patent unreasonableness" (*MacKay v. Canada* [2002] 2 C.T.C. 138 (F.C.T.D.)). With limited exception, the taxpayers have generally been unsuccessful in having the courts reverse the Minister's decisions. The courts will generally not "second guess" the Minister in the absence of bad faith, ignorance of relevant facts, consideration of irrelevant facts, or illegality. For example, see *Housser v. The Queen* [1994] 2 C.T.C. 2233 (T.C.C.); *Lindstrom v. The Queen* [1994] 1 C.T.C. 2525 (T.C.C.); *Towers v. The Queen* 94 D.T.C. 6118 (F.C.T.D.); *Ford Estate v. The Queen* 93 D.T.C. 5499 (F.C.T.D.); *Barron v. The Queen* 96 D.T.C. 6262 (T.C.C.), reversed on appeal 97 D.T.C. 5121 (F.C.A.) and *McLean* 2007 D.T.C. 5654. Yet for taxpayer success, see *Grant v. MNR* (February 10/99 - F.C.T.D.); *Hillier v. The Queen* [2001] 3 C.T.C. 157 (F.C.A.); *Bilida v. The Queen* [1997] 2 C.T.C. 143 (F.C.T.D.); *Miller v. The Queen* 2004 D.T.C. 6057; *Hindle v. The Queen* [2004] F.C. (F.C.T.D.); *Comeau v. CCRA* (August 10, 2005 (F.C.A.)), *Carter-Smith* 2006 D.T.C. 6707 (F.C.T.D.) and *McLeod Estate* 2007 D.T.C. 5623; *Telfer* 2008 FC 218, reversed 2009 FCA 69.

9. Collections Practices and Payment of Taxes in Dispute

Taxpayers often ask if they should pay amounts in dispute even though they do not believe the money is owing and that they intend to dispute the amount. This is a discussion for which the professional should be prepared. The short answer to that question is that it depends on the taxpayer's circumstances.

By virtue of section 225.1 of the Act, there is usually a delay in collection proceedings until the ultimate resolution of the dispute. Once the dispute is resolved, Canada Revenue Agency may begin collection immediately. The collection powers available to the Canada Revenue Agency are discussed later in the paper.

9.1 Factors to Consider in Deciding Whether to Pay

The most significant drawback of not paying is the accumulation of non-deductible interest charged under the *Act*. Interest is compounded daily and is charged at prescribed rates which are set quarterly. The prescribed rate of interest is currently the average weekly yield on three-month Government of Canada Treasury Bills plus four per cent.

If a taxpayer chooses to pay the amount of an assessment which is in dispute and the taxpayer is ultimately successful on an objection or an appeal, any amounts paid will be refunded with interest compounded daily at Canada Revenue Agency's prescribed rates from the date of payment. Any interest paid will be taxable to the recipient in the year in which it is paid.

Other factor to consider include:

- the likelihood of success;
- the taxpayer's ability to pay;
- the taxpayer's ability to generate a better return than the prescribed rate of interest; and
- the spread between the prescribed rate and the prevailing commercial rates.

A taxpayer that carries on a business could borrow the money to pay the assessment and then deduct the interest against business income. Borrowing money is less attractive if the taxpayer's business is losing money. Individual taxpayers may not deduct interest charged on funds borrowed to pay assessed amounts. Nonetheless, where an individual can borrow money at a rate lower than Canada Revenue Agency's prescribed rate, it may still make financial sense to borrow and pay the assessment to stop non-deductible interest from accruing on the assessed amounts. If an individual taxpayer has funds available to pay an assessed amount, the taxpayer may wish to pay the assessed amount to stop interest from accruing, given that any interest income earned by an individual on investments such as bonds or bank accounts is subject to tax. To determine whether it would be beneficial in the latter case, the taxpayer could compare his or her after-tax return on the investment monies to Canada Revenue Agency's prescribed rate at the time, taking into account that any interest ultimately paid to Canada Revenue Agency would have to be paid with after-tax dollars. For corporate taxpayers only, the CRA has reduced the refund interest rate to the "prescribed rate" rather than the "prescribed rate" plus 2%.

Payment of an assessment will not prejudice a taxpayer's chances of successfully disputing it although to avoid any dispute the tax lawyer will submit a letter with payment reserving the right to dispute the amount paid.

Where an appeal is instituted or maintained without reasonable grounds and with a view to deferring the payment of an amount payable under the *Act*, the taxpayer is liable to a penalty of up to ten per cent of the amount in issue (section 179.1). The purpose of this penalty is to discourage frivolous tax appeals instituted to defer the payment of tax.

9.2 Exceptions to the General Rule

A corporate taxpayer that is subject to the federal large corporations tax (LCT) will be required to pay 50 per cent of the amount of taxes, interest and penalties in dispute where an objection is filed after 1991. All taxpayers must pay the full amount of taxes, interest and penalties not in dispute.

9.3 Section 225.1 Not Applicable

The collection restrictions in section 225.1 do not apply to all types of amounts payable under the *Act* (subsection 225.1(6)). Excluded from the restrictions are amounts payable under Part VIII of the *Act* which deals with R&D tax credits, amounts deducted or withheld and required to be remitted, amounts payable under section 116 of the *Act* relating to certain dispositions of

property by non-residents and generally any penalties or interest relating to these amounts. It is unclear whether collection restrictions do apply to assessments under section 160 and 227.1 of the *Act*. Canada Revenue Agency can collect without restriction amounts assessed under subsection 152(4.2) (i.e. after an application for assessment by the taxpayer) subsection 169(3) (i.e. disposition of an Appeal) and subsection 220(3.1) (i.e. waiver of penalty or interest).

The filing of a notice of objection does not always prevent Canada Revenue Agency from collecting the assessed amount. The *Act* provides for "jeopardy collections" and these are discussed later in the paper.

If a taxpayer wishes to put a notice of objection in abeyance pending the outcome of a "test case" the taxpayer should beware of subsection 225.1(5). It allows the CRA to take collection action shortly after the test case has been concluded.

9.4 Summary

Immediate collection of taxes in dispute is permitted only in exceptional circumstances. In most cases where a taxpayer objects or appeals from an assessment, the taxpayer has the legal right to delay payment of the assessed amount. Whether or not it is beneficial for the taxpayer to exercise this right will depend on a number of factors including:

- the likelihood of a resolution of the dispute in the taxpayer's favour;
- Canada Revenue Agency's prescribed interest rates at the time;
- whether funds are available to the taxpayer and whether these funds are earning taxable investment income;
- whether the taxpayer has the ability to borrow and to deduct interest paid on borrowed monies; and
- the interest rate at which monies can be borrowed.

PART V - DEALING WITH THE CANADA REVENUE AGENCY DURING THE AUDIT

1. Commencement of the Tax Audit

A tax professional's involvement may commence with a call from the client stating that Canada Revenue Agency has requested a date upon which to commence an audit of the taxpayer. Although the early audit stage is merely a fact-finding effort by Canada Revenue Agency, it may become part of a litigation process that started with the filing of the taxpayer's return and may end in a decision of the Tax Court. The audit period is one in which a tax professional and the taxpayer can establish procedures for handling any questions that arise during the audit. For example, the taxpayer should copy all documents sent to Canada Revenue Agency. Otherwise, the tax professional will be at a disadvantage in any discussions with Canada Revenue Agency. Generally, the taxpayer should be co-operative with the Canada Revenue Agency auditor within the legal limits prescribed by the *Act* as many assessments or reassessments result because the auditor has a feeling that the taxpayer is hiding something. The client should however be made

aware of the limitations on Canada Revenue Agency's power to gather information and documents. These limitations are discussed later in the paper. It is interesting to read the CRA Pamphlet entitled "What You Should Know About Audits" (RC4188).

2. Matters Discussed at First Meetings

There may be a meeting between the taxpayer and Canada Revenue Agency. Tax professionals may attend with larger clients when the issues are complex and require both accounting and legal background. In any event, first meetings should focus on the following:

- the taxation years involved and legislation under consideration;
- the anticipated duration of the audit;
- the Canada Revenue Agency personnel who will involved - not only those who will attend at the client's site but also those supervisors and technical support personnel who will be working at the Canada Revenue Agency facilities and whether any downloading of computer information may be required;
- focus of the audit - are there any specific issues that Canada Revenue Agency is considering;
- which "books and records" Canada Revenue Agency requires for review;
- mechanism for the Canada Revenue Agency official to take photocopies;
- mechanism for the Canada Revenue Agency official to obtain additional information - for example should requests for additional information be reduced to writing.

Some of the focus of the pre-audit meeting is simply to make sure that the audit is orderly for Canada Revenue Agency and also that it minimizes the difficulty for the taxpayer in carrying on its business during the course of the audit. Canada Revenue Agency has switched to a "single-window service" in which a taxpayer has a single business number and audit teams are comprised of income tax auditors, GST auditors and customs auditors.

3. Large Business Audits, Specific Projects and The Audit Protocol

For "large case" taxpayers (annual gross revenue over $250,000,000) specialist teams deal with complex issues. Canada Revenue Agency meets with large businesses to also develop a three-to-five year audit strategy. A "large case" taxpayer may also request a "real time" audit, that is to say, an audit of their return at the time it is being prepared. A real time audit can have an extremely narrow focus such as a single issue. Canada Revenue Agency has issued a booklet on its Audit Protocol designed to encourage participation in these measures. Some taxpayers are uncertain whether to enter into an Audit Protocol Agreement and whether it offers any benefits. For a good discussion, see "The Audit Protocol Agreement – A Critical Perspective" (1998), 11 *Canadian Petroleum Tax Journal*.

4. Role of the Professional

During the audit, the professional's role will likely be to monitor the audit through the taxpayer. As the audit tends to be a gathering of information, the professional may do little else but help the taxpayer forward the appropriate information permitted by law on to Canada Revenue Agency. Make sure that the client keeps copies of all documents and information provided to Canada Revenue Agency. The taxpayer may also request assistance in responding to any questions asked by Canada Revenue Agency. It is therefore always useful to ask Canada Revenue Agency to reduce questions to writing.

5. Typical Auditor Concerns

It is important to identify the auditor's concerns. The auditor's concerns may be based on some or all of the following:

- an inaccurate or incomplete understanding of the facts, the evidence to support the facts and the laws applicable to those facts;
- the concerns of others such as his or her head of audit or an industry-wide audit;
- another government may have asked Canada Revenue Agency to assist it by reviewing the records of a Canadian affiliate;
- Canada Revenue Agency may have received a third party tip and is attempting to verify the tip;
- there may be a follow up audit as a result of an earlier audit.

Identifying the auditor's concerns will help in avoiding a reassessment. Often issues gain momentum without any basis and become difficult to later resolve. By identifying the auditor's concerns, one can make sure that the auditor has complete and accurate information about the facts relating to that issue and can make sure that his or her information is reduced to writing so that the taxpayer's record contains all of the relevant information.

6. The "30 Day Letter" or "Proposal Letter"

6.1 What Is It?

Prior to reassessing a taxpayer, Canada Revenue Agency typically writes to the taxpayer and proposes to reassess on one or more bases. The letter usually concludes by asking for a response within "30 days" and thus is typically called a "30 day letter" or "proposal letter". The letter arrives at an important point in time in the audit process and accordingly a response to Canada Revenue Agency that is accurate and detailed is usually necessary. If 30 days is not a sufficient time period within which to respond, Canada Revenue Agency should be asked for an extension. Canada Revenue Agency tends to be flexible in this regard unless a limitation period is about to expire. A reassessment would then follow in the absence of an executed waiver.

6.2 How Should The Letter Be Handled?

It is usually prudent to respond to a 30 day letter by written submission. This may seem expensive to the taxpayer, but it will save money later because the submission may be used as the basis for pleadings and memoranda of law in subsequent processes. In a written submission, one should organize the information and position in accordance with the issues raised by Canada Revenue Agency. Do not try to anticipate Canada Revenue Agency's subsequent positions or create additional issues. As a result, there are three uses for a written submission:

(d) One can supplement, clarify or challenge the facts as presented by Canada Revenue Agency or the sources upon which Canada Revenue Agency is relying;

(e) One may supplement, clarify or challenge the law as stated in Canada Revenue Agency's 30 day letter;

(f) One will create a written record of what has been said to Canada Revenue Agency. Often Canada Revenue Agency has taken written notes upon conversations and these contain inaccuracies or as would be expected "have been taken out of context".

It is also important to note the facts contained in the 30 day letter. These may very well form the basis of the facts and assumptions in the litigation before the Tax Court. It is often useful to have Canada Revenue Agency go on the record as to their understanding of the facts which have occurred and have resulted in the reassessment.

7. Moving Beyond the Audit to the "Next Level"

During the course of discussing the issues with Canada Revenue Agency, the professional must consider whether it is even possible to obtain a settlement at this level. Often, auditors have invested a great deal of time in their audit and do not want to conclude the audit with the conclusion that no adjustments are necessary. Accordingly, at a certain point in time, the professional must advise the client that money is being wasted by continuing to talk with the auditor. If the auditor refuses to cooperate, it may be worthwhile to contact the auditor's team leader or technical advisor at Canada Revenue Agency to arrange a meeting at which Canada Revenue Agency's position should be clearly ascertained.

8. Waiver of Objection Rights

As part of a settlement, CRA may ask the taxpayer to execute a waiver of rights of objection (see subsections 165(1.1) and 169(2) of the *Act*).

PART VI - CANADA REVENUE AGENCY POWERS AND LIMITS ON DISCLOSURE

The auditor cannot do the appropriate job to verify information in the taxpayer's return to enforce the *Act* without using the powers given by the *Act*. This section of the paper reviews the scope of these investigative powers.

1. Investigatory Powers Of Tax Officials Prescribed By The *Act*

The *Act* gives Canada Revenue Agency four investigative powers, each of which is discussed separately:

- inspection;
- requirement of domestic and foreign-based documents and information;
- search and seizure; and
- inquiry.

1.1 Inspection - Section 231.1

Section 231.1 sets out various powers available to Canada Revenue Agency that are normally used in the course of a field audit. Generally speaking, auditors on the staff of the District Taxation Office visit the offices of taxpayers to assemble information about the affairs of one or more taxpayers. For simplicity, the analysis has been broken down into the following categories:

- Who may enter the premises?
- Where is the person permitted to enter?
- When may the authorized person enter the premises?
- For what reason may an authorized person enter premises?
- What are the specific inspection powers available to Canada Revenue Agency under Section 231.1?
- What may be examined?
- To what extent must a person comply?

1.2 Who May Enter The Premises?

Any person authorized by the Minister of National Revenue may do so. This includes the Commissioner of Revenue, who may exercise all powers and perform all duties of the Minister under the *Act*. Subsection 220(2.01) permits the Minister to delegate his powers and duties under the *Act* to an officer or class of officers in the CRA. This replaces the former requirement under paragraph 221(1)(f) that such delegation be done by regulation (former Regulation 900).

1.3 Where Is This Person Permitted To Enter?

An authorized person may only enter premises or places where:

- any business is carried on;
- any property is kept;
- anything is done in connection with any business;
- any "books or records" (likely those under section 230) are or should be kept.

Yet if any premises or place constitutes a "dwelling house" (as defined in section 231), an authorized person may not enter that dwelling house without the consent of the occupant except under the authority of a warrant authorizing the person to enter the dwelling house. Under subsection 231.1(3), a "Judge" (as defined in section 231) shall issue a warrant following an *ex parte* application when he is satisfied by information on oath of the following factors:

- there are reasonable grounds to believe that a dwelling house is a premises or place where any business is carried on, any property is kept, anything is done in connection with any business or any records or books are or should be kept;
- entry into a dwelling house is necessary for any purpose relating to the "administration or enforcement of the *Act*" (see 1.5 below); and
- entry into the dwelling house has been refused or there are reasonable grounds for believing that it will be refused.

Should the Judge refuse to issue a warrant because the Judge believes that entry is not necessary for any purpose relating to the administration and enforcement of the *Act*, the Judge may:

- order the occupant to provide reasonable access to Canada Revenue Agency to any document or property that is or should be kept in the dwelling house;
- order other things as are appropriate in the circumstances to carry out the purposes of the *Act*;

to the extent that access has been or may be expected to be refused and the document is or may be expected to be kept in the dwelling house.

1.4 When May The Authorized Person Enter The Premises?

The authorized person under section 231.1 may do so at all "reasonable" times. Usually an auditor will contact the taxpayer to arrange a convenient date to commence the field audit. However, there is no guarantee that an auditor or officer from Investigations (i.e. the "Tax Police") will not show up at any time during business hours without warning to examine books and records to obtain information about any taxpayer.

1.5 For What Reason May An Authorized Person Enter Premises?

The auditor may do so "for any purpose related to the administration or enforcement of the *Act*". This expression has been defined in a number of cases. These cases include:

- *Canadian Bank of Commerce v. A-G Canada* 62 D.T.C. 1237 (S.C.C.);
- *James Richardson & Sons v. The Queen* 82 D.T.C. 6204 (F.C.A.);
- *R. v. Bruyneel* 86 D.T.C. 6119 (B.C.C.A.);
- *McKinley Transport* 90 D.T.C. 6243 (S.C.C.);
- *Canadian Forest Products et al.* 96 D.T.C. 6506 (F.C.T.D.);
- *AGT Limited* 96 D.T.C. 6388 (F.C.T.D.), affirmed 97 D.T.C. 5189;
- *Federation de Caisse Populaire Desjardins* (Sept. 19, 1995, unreported Q. Sup. Ct.); and
- *Greater Montreal Real Estate Board* 2007 FCA 346.

In brief, these cases establish that the phrase means that the Minister would have to satisfy a Court that there is an inquiry either to determine the tax liability of a specific person(s) or to verify compliance with the *Act* by identifiable persons. The person or persons do have to be named, and it is not sufficient if information is sought about a specific class of persons. Apparently it is still Canada Revenue Agency policy not to request information except when a specific taxpayer is under audit or investigation.

1.6 What Are The Powers Available To Canada Revenue Agency Under Section 231.1?

An auditor may exercise the following powers:

- inspect, audit, or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by him under the *Act*;
- examine property in an inventory of a taxpayer or any property or process of or matter relating to the taxpayer or any other person, an examination of which may

assist the authorized person in determining the accuracy of the inventory of the taxpayer;

- examine property in an inventory of a taxpayer or any property or process of or matter relating to the taxpayer or any other person, an examination of which may assist the authorized person in ascertaining the information that is or should be in the books or records of the taxpayer or any amount of any tax payable by the taxpayer under the *Act*;

- require the owner or manager of the property or business and any other person on the premises or place (of business) to give the authorized person all reasonable assistance, and to answer all proper questions relating to the administration or enforcement of the *Act*;

- require the owner or manager of the property or business to attend at the premises or place with the authorized person;

- make one or more copies of any document (including print outs of electronic documents), property in an inventory, any property or process or matter relating to the taxpayer or any other person.

1.7 What May Be Examined?

An auditor may review "books or records" of the taxpayer or "documents" of the taxpayer or any other person. "Documents" include money, a security and a record. A "record" is defined by the *Act* to include invoice, account, book, agreement, chart or table, diagram, image, map, memorandum, plan, return, voucher, letter, telegram, statement (financial or otherwise) and any other thing containing information (whether in written or any other form) that relates or may relate to the information that is or should be in the books or records or that relates or may relate to the amount of tax payable by the taxpayer under the *Act* and also includes computerized information. The auditor may also examine property in an inventory or any property, process or matter relating to the taxpayer or any other person which may assist in determining the accuracy of inventory of the taxpayer or in ascertaining the information that should be in the books or records of the taxpayer or any amount payable by him under the *Act*.

It is debatable whether documents such as tax planning memoranda fall within any of these categories. The documents contemplated should be those which permit the taxes payable or the taxes on other amounts to be collected, withheld or deducted by a person to be determined.

1.8 To What Extent Must a Person Comply?

A taxpayer or the affected person has certain responsibilities:

- no hindering, interfering or molesting to prevent proper copying, proper audit, proper examination or proper inspection under Section 231.1;

- no prevention of or attempt to prevent these activities;

- the provision of "all reasonable assistance and the response to all proper questions";

Subsection 231.5(2) provides that a taxpayer shall comply unless he is "unable to do so". There is no definition of this phrase in the *Act* and there has been little discussion in the case law: *R. v. Bourassa*, [1968] C.T.C. 412 (B.C.S.C.); *R. v. Arvai*, [1977] C.T.C. 263 (Ont. Prov. Ct.); *Muir v. The Queen*, [1979] C.T.C. 259 (Ont. Co. Ct.). Generally speaking, a duty of confidentiality owed to a client or former client or employer will not override (See the discussion of solicitor-client privilege, below). Physical infirmity or inaccessibility should provide sufficient excuse.

There has been little discussion in the case law of what constitutes "reasonable assistance". In *MNR v. Potoroyko* 83 D.T.C. 5113 (Sask. Prov. Ct.) and *MNR v. Rolbin* (1982, unreported) it was interpreted as such assistance as is reasonable in the circumstances to enable the authorized person to carry out his task of audit examination. However, it does not mean that the taxpayer has to do the auditor's job and prepare new documents. Reasonable assistance may however extend to obtaining records from which to retrieve information or to explaining procedures or documents. "Proper" questions should be relevant and must only relate to the named taxpayer about the administration and enforcement of the *Act*.

A failure to comply is an offence under the *Act* and a person, if guilty, may be liable on summary conviction for a fine and possibly imprisonment under subsection 238(2). What constitutes a proper question for the purpose of this provision was in issue in *The Queen v. Marcoux* [1985] 2 C.T.C. 254 (Alta. Prov. Ct.).

Failure to comply with a section 231.1 request may result in the issuance of a compliance order by a court to do so (section 231.7).

1.9 Compliance Order Under Subsection 231.7

On summary application by CRA, a judge may order a person to provide any access, assistance, information or document sought by the Minister under sections 231.1 or 231.2 of the Act. Solicitor-client privilege is a defence. Compliance orders are becoming routine. See *Cornfield* 207 F.C. 436, *Jourdain* 2007 F.C. 739 and *Morton* 2007 F.C. 503. A taxpayer may still be prosecuted for failure to comply (section 238), notwithstanding the issuance of a successful compliance order.

1.10 Audit Working Paper Requests

In 2005, in Canadian Tax Highlights, Paul Hickey of KPMG wrote:

> "A task force established by the Canadian Institute of Chartered Accountants (CICA) to consider the CRA's policy on requesting access to accountants' and auditors' working papers recently made a submission to the CRA on the issue. The submission sets out the task force's concerns about the lack of a consistent policy on access to working papers, details international developments that the task force believes are critically relevant to CRA policy and Canadian competitiveness, and offers a principled rationale for

limiting requests for access to accountants' and auditors' working papers to exceptional circumstances such as fraud or misrepresentation.

At the Canadian Tax Foundation's 2004 annual conference, CRA officials stated that the CRA would conduct a broad-based consultation with the tax, accounting, and business communities on clarification of its policy, particularly with respect to access to working papers that deal with the analysis of tax provisions, tax liabilities, or reserves. Traditionally, as a matter of policy, requests to examine accountants' or auditors' working papers were not routine, a policy that the task force understands was included in CRA guidelines for obtaining information from accountants. The guidelines also provided that "it is not the policy of the CRA to request a general access to accountants' working papers for the purposes of scrutinizing them in the course of conducting an audit." According to the task force, this policy recognized the inherent tension between an auditor's need to access all relevant tax information for the purposes of preparing an audit of the company's financial statements and the legitimate desire of the company to protect communications with its professional advisers in addressing its need for tax advice.

Despite this longstanding policy, the task force points out that certain regional CRA offices have apparently adopted an administrative practice of initiating broad requests for auditors' working papers. In 2003 and 2004 there were anecdotal reports that general requests for audit working papers frequently emanated from certain CRA offices. The task force says that such broad requests impede efforts by accountants and auditors to facilitate responsible and legitimate disclosure within the self-assessment tax system.

Working papers prepared by an auditor reflect its views on fulfilling its responsibility to probe, question, and exercise its professional judgment for the purposes of forming an opinion relative to a corporation's financial statements. The task force points out that it is important to distinguish between those papers and the working papers generated when the annual tax return is prepared.

The task force recommends that the CRA adopt a clear national policy of requesting working papers and information only in exceptional and well-defined circumstances in order to preserve important values – open and frank communication between auditors, accountants, and their clients (which is critical to the proper functioning of the self-assessment tax system and to an

atmosphere of disclosure and compliance), and access to the information required for high-quality audits (which are essential for public confidence in the capital markets). Accordingly, the task force presents a proposed draft policy and protocol, which recommends that the CRA adopt a policy of seeking access to certain information and documents from the taxpayer, its auditors, or its accountants only in "exceptional circumstances". Such circumstances are defined as those in which (1) the CRA has a reasonably well-founded suspicion of fraud, evasion, or other offence under the Act; (2) the taxpayer's source documents have been lost or destroyed, are otherwise unavailable, or are not made available by the taxpayer; and (3) the CRA cannot otherwise obtain sufficient information to evaluate the taxpayer's income tax arrangements, or the taxpayer's source documents do not provide sufficient information for the CRA to properly evaluate a taxpayer's arrangements.

In conclusion, the task force says that the CRA's current regional administrative practice on access to working papers creates a conflict between an accountant's role in the reporting of financial information to capital markets and the efficient functioning of the tax system. Broad CRA powers to question auditors and professional advisors about a client's subjective intentions and to obtain access to audit working papers create a paradox, according to the task force. Auditors are being held to a much higher standard of accountability for the accuracy of financial information being provided to capital markets; on the other hand, if left unchecked, the CRA practice of requesting access to audit working papers will create disincentives for clients to speak openly with their auditors and advisors.

According to the task force, other countries, especially Australia and the United States, have crafted a balance between the concerns of capital markets and those of tax authorities that the task force believes the CRA would be wise to replicate. For example, the task force says that limiting requests for working papers to unusual circumstances and otherwise confirming a policy of restraint in the manner articulated by US authorities would achieve the balance of candour and confidentiality that a national policy must recognize. The submission also outlines developments in the United Kingdom and New Zealand that it says the CRA should consider.

The task force recommends the establishment of an internal national review committee within the CRA to assess proposed instances of exceptional circumstances in order to achieve a consistently applied national policy."

At the 2007 CRA Roundtable at the Canadian Tax Foundation Annual Conference, CRA announced that CRA continues to collaborate with the CICA Task Force on Auditor Working Papers and Confidentiality. A policy is still being drafted and will be circulated for comments. This is a significant issue in the U.S. and the courts there have determined that such working papers are not subject to litigation privilege. (*Textron*)

There is litigation ongoing in Canada about the release of audit working papers. This involves PWC and CRA, with intervention by Ford Motor Group and the CICA. A draft of the CRA policy is found in the Federal Court files.

For further discussions, see Kingissepp and Henry 2009 Canadian Tax Foundation Annual Conference Report referenced in the bibliography.

2. Provision of Documents or Information - Sections 231.2 and 231.6

Taxpayers, practitioners or third parties who do not willingly provide information or documents may receive, by personal service or registered mail, a "requirement" to do so. One or more requirements may be issued under sections 231.2 or 231.6 of the Act. Under subsection 238(2), failure to comply with such a requirement may constitute an offence under the *Act* punishable by fine and possibly imprisonment. See *Regina v. Smith* (2005 B.C.P.C. 0046 (B.C. Prov. Ct.)). In the case of foreign-based information, failure to comply substantially may prohibit a taxpayer from introducing in civil proceedings any information or document covered by that notice (subsection 231.6(8)). See *Glaxo Smith Kline Inc.* 2003 D.T.C. 918 (T.C.C.). Failure to comply with a section 231.2 requirement may result in the issuance of a compliance order by a court to do so (section 231.7) (see section 1.9 above) and possible prosecution under section 238 (*Regina v. Lemieux* 2007 SKPC 135 (Prov. Ct. Sask.). See *Iwaschuk* 2004 D.T.C. 6371 (F.C.T.D.). Requirements are often exceedingly broad in scope and may relate to domestic and foreign information. For recent reviews of this area, see *Lindsay*, 2008 CTF Conference Report and *Heddema,* 2008 CTF BC Tax Conference.

2.1 Who May Require the Provision of Documents and Information?

Only certain parties in addition to the Minister, Deputy and Assistant Deputy Minister may authorize the issuance of a requirement. One must consider whether the Minister's authority has been duly delegated under subsection 220(2.01) to ensure that the requirement has been properly issued. See *Murphy* 2009 FC 1226.

2.2 What May Be Demanded?

The "requirement" contemplated by Section 231.2 of the *Act* may seek:

- "any information or additional information, including a return of income or a supplementary return"; and
- any "document" (see section 231) which includes money, securities, and any of the following (whether computerized or not): books, records, letters, telegrams, vouchers, invoices, accounts and statements (financial or otherwise).

A requirement mandated by Section 231.6 of the *Act* may seek "any information or document which is available or located outside Canada and which may be relevant to the administration or enforcement" of the *Act*. Canada Revenue Agency has indicated that it will rely on Section 231.6 to obtain foreign-based information or documents that may be relevant to the administration and enforcement of the *Act*, notwithstanding that the particular information may pertain to a taxation year that is prior to the enactment of the provision.

In either case, the information sought must be for "a purpose related to the administration or enforcement of the *Act*". A decision of the Federal Court of Appeal, *Tower v. The Queen* 2003 D.T.C. 5540, considered the scope of this phrase as well as the scope of the requirement power to cause taxpayers to furnish information that did not already exist. The Court found that taxpayers and their accountants were obliged to do so. Does section 231.2 require a Canadian resident to provide information to which it has access in Canada but is stored in data facilities owned by another party located outside of Canada? In *eBay Canada Limited and eBay CS Vancouver Inc. v. MNR* 2007 F.C. 930, Hughes, J. determined that the information cannot be truly said to "reside" only in one place or to be "owned" by only one person. The reality is that the information is readily and instantaneously available to those within the group of eBay entities in a variety of places. It was irrelevant where electronically stored information is located or who as among those entities by agreement or otherwise asserts "ownership" of the information. The use of the information in Canada was critical as the information could be summoned up in Canada and for the usual business purposes of eBay Canada. Location of the electronic storage apparatus outside Canada for corporate efficiency did not assist the taxpayer. The information was considered "Canadian" and not "foreign". The eBay litigation has a number of subsequent decisions. See 2008 FC 180, 2008 FCA 141 and 2008 FCA 348. See E. Kroft, "Requirement Letters and Technology" December 4, 2008 Tax Topics (CCH).

2.2.1 "Fishing Expeditions" and *Ex-Parte* Orders – Subsection 231.2(3)

To avoid problems raised in apparent "fishing expeditions", the *Act* permits the provision of information or documents on unnamed persons in limited circumstances. The Minister, under Section 231.2, shall not impose on any person (third party) a requirement to provide information or any document relating to one or more unnamed persons unless he first obtains the authorization of a Judge of the provincial superior court or a Judge of the Federal Court. That authorization may be subject to conditions, and it will be granted following an *ex parte* application only if the Judge is satisfied by information on oath that:

- the person or group is ascertainable; and
- the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under the *Act*;

The judicial authorization in Section 231.2 regarding "unnamed persons" may be subject to judicial review within 15 days after the service of notice and may be cancelled, confirmed or varied depending on certain circumstances. Section 231.6 contains a procedure whereby a Judge may review the requirement for "foreign-based information" within 90 days of service. No judicial authorization is required before the notice is sought. The Judge may review the notice and vary or set it aside for being unreasonable.

There are a number of reported decisions regarding review of judicial authorizations or in which requirements were partially quashed because no judicial authorization was first obtained. *Paquette v. MNR* 92 D.T.C. 6394 (F.C.T.D.) is a decision which considers a demand for documents and solicitor-client privilege. In *Paquette*, the client failed to comply with a demand for documents, pleaded guilty to the offence of failing to comply under subsection 238(1) and paid a fine. Canada Revenue Agency then placed a demand on Mr. Paquette, the client's lawyer. The demand requested that he provide:

> "all trust account records, including ledger cards, journal entries and cancelled cheques that are known to be or to have been related to entries or transactions with, for, or on behalf of the individual named above, or persons known to be or have been acting on behalf of the above-named individual ..."

The client refused to waive privilege and as a result Mr. Paquette had no choice but to defend the privilege. There were two issues before the Federal Court. First, was the demand invalid because it was not part of an ongoing investigation? The only evidence on this issue was that of a Canada Revenue Agency official who testified that the demand related to a collection matter. The Court found as a result that the demand did relate to an ongoing investigation.

The second issue was whether the request for documentation from "persons known to be or have been acting" invalidated the return. Mr. Paquette argued that the request related to an unnamed person as defined in subsection 231.2(2). That subsection requires Canada Revenue Agency to obtain the authorization of a judge before making a demand relating to unnamed persons. The demand had been sent to Mr. Paquette personally and not to his firm. As a result, all other lawyers in his firm were unnamed. The Court agreed with the argument but disagreed with the effect of the failure to obtain judicial authorization. Mr. Paquette argued that the request invalidated the entire demand. The Court concluded that the "unnamed person" portion invalidated only the request relating to unnamed persons. As a result and on the basis of the definition of "privilege" in the *Act*, Canada Revenue Agency was permitted to examine the requested documents in Mr. Paquette's files.

Andison v. MNR 95 D.T.C. 5058 (F.C.T.D.) is also a decision concerning a demand for documents relating to unnamed persons. Once again, the court held, following *Paquette*, that the part of the demand relating to unnamed persons was invalid. In *Andison*, Canada Revenue Agency made a demand on Mr. Andison as a result of a request by the IRS. The demand did not specifically disclose this purpose for the demand but Mr. Andison was notified of the purpose. Mr. Andison argued that the failure to include the correct purpose in the demand invalidated the demand because the demand was not made for the purpose of administering the *Act*. The Court held that the failure to include the purpose did not invalidate the demand. Article XXVII of the Canada-U.S. Tax Treaty endorsed this type of demand. Mr. Andison was successful on the "unnamed persons" issue. In the demand, Canada Revenue Agency requested documentation relating to an individual and all corporations of which the individual was a shareholder. The Court agreed that these corporations were "unnamed persons" and that part of the demand was quashed because Canada Revenue Agency failed to obtain judicial authorization.

In *Canadian Forest Products* 96 D.T.C. 6506 (appeal withdrawn to F.C.A.), documents relating to sales of goods were not considered by the Federal Court to be the proper scope of a requirement when the taxpayers served with the requirement were not under audit. Different conclusions regarding the scope of the requirement and the exercise of the judicial review were delivered by the Federal Court of Appeal in *AGT Limited* 97 D.T.C. 5189 and *Sand Exploration* 95 D.T.C. 5469.

Capital Vision Inc. 2003 D.T.C. 5054 shows that CRA cannot deliver a requirement to a particular taxpayer to obtain information it wants about other unnamed taxpayers without getting a court order. See also *Artistic Ideas Inc. v. Canada Revenue Agency* 2004 D.T.C. 6348 (F.C.T.D.), affirmed 2005 FCA 68, regarding the ability to redact documentary responses to requirements. See also *The Queen v. TD Bank* 2004 D.T.C. 6095 (F.C.T.D.), appeal dismissed 2004 D.T.C. 6700 (F.C.A.). Compare the decision in *Artistic Ideas* with that in *Redeemer Foundation* 2006 D.T.C. 6712 (FCA) in which judicial approval was not required before a charitable foundation was to provide its list of donors to CRA. The FCA determined that the Minister was otherwise entitled to obtain this information under section 231.1 of the Act. This was confirmed by the Supreme Court of Canada in July 2008. (2008 DTC 6474). See also the FC decision in *Amex Bank* 2008 GTC 1357.

For recent decisions on subsection 231.6(3) and section 231.2, see *National Foundation for Christian Leadership* 2005 FCA 246.

A 2007 decision of the Federal Court of Appeal, *Greater Montreal Real Estate Board* 2007 FCA 346, reversed a decision of the Federal Court 2007 D.T.C. 5519. The Federal Court decision had reversed an *ex parte* order obtained by CRA authorizing the Minister to compel the taxpayer to provide information and documents about a group of unnamed persons. The order was issued in connection with the Minister's alleged audit of certified real estate agents and brokers in the territory served by the CRA's Montérégie/South Bank tax office. The purported objective of the inquiry was to assess whether the group of agents and brokers were reporting commission receivables from the sale of real estate properties.

The taxpayer's application was allowed. In order to compel the taxpayer to produce information and documents under paragraph 231.2(3)(*a*) of the Act, the Minister was required to establish (a) that the group of unnamed persons constituted an "ascertainable group", (b) the existence of a genuine and serious inquiry into the persons in the group covered by the request, (c) whether the information sought was sufficiently conclusive to warrant an authorization under subsection 231.2(3) of the Act, and (d) whether the Minister had reasonable grounds to believe that there was non-compliance with the Act, and the information was not otherwise readily available. The members of the group were identifiable and constituted an "ascertainable group" within the meaning of the Act. The Minister had discretion to choose which taxpayers to subject to an inquiry or audit in regard to their tax liability. However, the Minister failed to establish that a genuine and serious inquiry into the group was being conducted, and that the request for information was to determine whether each and every member of the group had complied with the Act in reporting their incomes. The compilation of general data on a class of persons could not amount to a genuine and serious inquiry within the meaning of section 231.2 of the Act. The previous court order authorizing the Minister's requirement for information was vacated.

In a unanimous decision, the Federal Court of Appeal determined that the test for obtaining an *ex parte* order was not whether CRA was conducting a "genuine and serious inquiry" about one or more individuals in the identified group. Trudel, J.A. stated that the issue was whether the applications judge was satisfied that the information or documents relating to one or more unnamed persons (forming an ascertainable group) was required to verify compliance with the *Act* (a tax audit conducted in good faith with a genuine factual basis). The Court analyzed the changes to section 231.2 and determined that the legislation should not be construed to add requirements that were not legislated. The removal of paragraphs 231.2(3)(c) and (d) permitted a type of fishing expedition, with Court authorization, for the purpose of facilitating CRA's access to information. The *Richardson* approach was necessitated by earlier versions of legislation. See also the *Amex* decision of the Federal Court.

2.3 Who Can Be Required to Provide Documents and Information?

The target of a requirement may be "any person" and not just the taxpayer. Therefore this would extend to persons not under investigation such as the accountant, lawyer, former employees, or parties to a business transaction. This can prove frustrating to a tax professional who no longer has a professional relationship with a client but may have a duty to protect the documents from disclosure notwithstanding that the production may take hours of work. The Ontario Court of Appeal held in *Canadian Bank of Commerce v. The Queen* 62 D.T.C. 1014 that even if the collection of information causes the person who must provide the information a great deal of inconvenience and expense it does not prejudice the validity of the demand. There may, however, be limits on how broadly the power may extend. Principles flowing from various decisions dealing with available evidence for transfer pricing cases (*Crestbrook Forest Industries v. The Queen* [1992] 1 C.T.C. 100 (F.C.A.), *A.M.P. of Canada, Ltd. v. The Queen* [1987] 1 C.T.C. 256 (F.C.T.D.) and *Canadian Forest Products* 96 D.T.C. 6506 (F.C.T.D.)) may impose limits on the circumstances under which third party information may be demanded by Canada Revenue Agency.

2.4 How Must the Requirement be Made?

Under either Section 231.2 or 231.6, the Notice must be served personally or by registered or certified mail. The proof of service by mail or personal service of a request or of a demand may be established by an affidavit of an officer of the Department of National Revenue and is received as prima facie evidence of the request or demand and of the sending by mail or of the personal service. The proof of service rules are set out in subsections 244(5) and (6). A judicial authorization granted under Section 231.2 to prompt the provision of information or documents about unnamed third parties must be served together with the notice.

2.5 To What Extent Must a Person Comply with the Requirement to Provide Documents or Information?

Both Section 231.2 and 231.6 use the term "require". In *The Queen v. Sherban* 74 D.T.C. 6403 (B.C. Co. Ct.) and *R. v. O'Donnell* 57 D.T.C. 6187 (Ont. C.A.), the Courts have concluded that the ordinary meaning of the word "require" carried with it a duty to comply and that the failure to comply would be an offence. The production or supply of information must be made "within such reasonable time as may be stipulated in the notice". Section 231.6 states that a reasonable

period of time is not less than 90 days "for the provision of foreign-based information". Section 231.2 is silent about a minimum standard of reasonableness. It is common for CRA to allow at least 30 days to comply. In *Licht v. The Queen* 90 D.T.C. 6574 (F.C.T.D.), the Court held that "10 days" was unreasonable. In *Joseph v. MNR* 85 D.T.C. 5391 (S.C.O.), "production without delay" was held to be unreasonable.

Subsection 231.5(2) provides that every person shall do everything he is required to do under section 231.2 and related provisions, notwithstanding any other law to the contrary. There are likely only limited circumstances in which failure to comply will be tolerated. As mentioned above, there is always the prospect of a compliance order application under section 231.7 of the Act or the prospect of prosecution under section 238. See *Brewer* 2009 NBPC 37.

Any disclosure will be subject to any proper claims for solicitor-client privilege. See section 5 below and *Welton Parent* 2006 D.T.C.6093 (FCTD).

2.6 Judicial Review of Section 231.6 Requirements

It has become common for CRA to issue both section 231.2 and section 231.6 requirements. The *Act* only refers to the review process for section 231.6 requirements (subsection 231.6(7)). Cases such as *Glaxo, European Marine Contractors* 2004 D.T.C. 6070 (F.C.T.D.) and *Sapiem Luxembourg S.A.* (see below) have involved a review by a judge who has three options available on a judicial review of the foreign-based requirements.

2.7 Expanded Use of Foreign Based Requirements – Section 231.6

Two decisions rendered in June 2005 by the Federal Court of Appeal and the Federal Court of Canada will encourage the CRA to use the provisions of section 231.6 of the *Act* more frequently. The decisions in *Saipem Luxembourg S.V. v. CCRA* 2005 D.T.C. 5348 (F.C.A.) and *1144020 Ontario Ltd. v. MNR* 2005 D.T.C. 5315 (F.C.) indicate that the Minister will be free to issue requirements for foreign-based documents or information pursuant to section 231.6 provided that such requirements are relevant to the administration or enforcement of the *Act* and that they are reasonable. The threshold for each of these tests appears to be very low. The eBay decisions referred to above show that an expanded view of section 231.2 may not necessitate the use of section 231.6.

2.7.1 Saipem

In *Saipem*, the CRA issued a requirement that Saipem produce for CRA's inspection the whole of its corporate records for its fiscal years ending July 31, 1999 and 2000. Saipem owned and operated very specialized vessels used for marine construction. Saipem contracted to employ one of its vessels in the procurement, transportation and installation of jackets and topsides for the Sable oil energy project. The work was done pursuant to a contract between Saipem and Saipem UK Limited, a related company which had in turn contracted with the owners of the Sable project, Mobil Oil Canada Properties. Saipem had filed its Canadian income tax returns for each of the relevant taxation years in which it had business income in Canada, but claimed that it was not taxable on its Canadian business income because it had no permanent establishment in Canada. Therefore the provisions of the *Canada Luxembourg Tax Convention*

would exempt the income from Canadian taxation. The Minister of National Revenue, however, had not yet issued notices of assessment in respect of the 1999 and 2000 taxation years because the CRA insisted that it was unable to do so until it could make an independent determination as to whether Saipem had a permanent establishment in Canada during the relevant period. Saipem had offered to produce to the CRA all of the documents relevant to its Canadian operations. CRA did not accept the offer of Saipem because it argued that Saipem would therefore become the judge of the relevance of the documents that it produced. Further, CRA argued that it had no means of verifying the information provided by Saipem other than by carrying out an audit of Saipem's books and records. Although Saipem offered to have the Tax Court of Canada decide whether it had a permanent establishment in Canada by virtue of Section 173 of the *Act* (which permits the decision on any question of fact, law or mixed fact and law as a preliminary proceeding), CRA rejected Saipem's offer because it did not believe it had the necessary facts to submit such a question to the Court.

Saipem applied to the Federal Court for a review of the requirement within 90 days of its service. Mr. Justice Rouleau of the Federal Court of Canada dismissed Saipem's application, relying on an earlier decision of the Court in *Merko v. Canada (Minister of National Revenue)* 90 D.T.C. 6643. Mr. Justice Rouleau determined that the test to be applied is whether the information was relevant to the administration of the *Act*. He further concluded that the CRA's duty to verify Saipem's tax liability necessarily required the production of its books and records.

Mr. Justice Pelletier, speaking for a unanimous panel of the Federal Court of Appeal (Desjardins, J.A. and Nadon, J.A. concurring), concluded that the appeal should be dismissed and that the requirement notice issued pursuant to Section 231.6 should be confirmed. He reviewed the relevant but limited jurisprudence on Section 231.6 and set out in paragraph 27 of the reasons the relevant criteria for judicial review of a Section 231.6 requirement:

> "The element which is present in Section 231.6, and which is lacking in Section 231.2, is the availability of judicial review of the notice of requirement on the ground of unreasonableness. Such a review lacks any substance if a notice of requirement is reasonable simply because the information requested is, or may be, relevant to the administration and enforcement of the Act. Given that Parliament took the trouble to provide for a review on the basis of reasonableness, I conclude that Parliament intended that a notice of requirement in respect of a foreign-based document must not only relate to a document which is relevant to the administration and enforcement of the Act but that it must also not be unreasonable."

He then determined that Mr. Justice Rouleau had failed to apply a standard of reasonableness when reaching his decision regarding the suitability of the requirement. Mr. Justice Pelletier proceeded to review the jurisprudence relating to the meaning of the term "reasonable" and determined that the requirement notice issued to Saipem had been reasonable. He concluded that the appropriateness of an audit is outside the mandate of the Federal Court judicial review under subsection 231.6(5) of the Act. What is important is for the Court to review the reasonableness of the requirement notice in light of the CRA's determination that an audit is required and not the reasonableness of the CRA's intention to conduct an audit. Further, the reasonableness of a

requirement notice is to be assessed according to its terms and not according to some alternate method of compliance. Therefore, whether the Agency's intention to conduct an audit of Saipem supported the need for a requirement notice in respect of the whole of Saipem's corporate records seemed reasonable. It was reasonable because, as he stated in paragraph 36:

> "It is the Agency's prerogative as to whether it will conduct an audit, and what form that audit will take. Given that the records in question are, by definition, maintained outside Canada, the Agency can do little more to gain access to the records than issue the notice of requirement which it issued here. If the result is an audit which does not meet the Agency's usual standards, it is nonetheless the best audit the Agency can conduct in the circumstances."

When reaching these conclusions, Mr. Justice Pelletier used the concept of "reasonableness" adopted by the Supreme Court of Canada in the *Law Society of New Brunswick v. Ryan* 2003 SCC 20 at paragraph 47:

> "The standard of reasonableness basically involves asking 'after a somewhat probing examination, can the reasons given, when taken as a whole, support the decision?'."

He further stated that, when applying this concept to a review of requirement notices under subsection 231.6(5) of the *Act*, a Court needs an understanding of the extent of the demand set out in the requirement notice and the reasons for which it is made. He further quoted from the *Merko* and *Bernick* (2002 D.T.C. 7167) decisions to demonstrate that a requirement will be reasonable where "the link between the documents where production was sought and the individual's tax liability is obvious and reasonable". He further accepted that, with respect to Saipem, all of Saipem's books and records were relevant to an audit even if some of them only served to verify, after being examined, that they have no impact on Saipem's Canadian tax liability. In reaching this conclusion, he relied on the Supreme Court of Canada decision in *McKinlay Transport*, 90 D.T.C. 6243.

2.7.2 <u>1144020 Ontario Ltd.</u>

In *1144020 Ontario Ltd.*, the taxpayer sought to set aside three requirement notices for the production of information and documents issued pursuant to subsection 231.6(2) of the *Act* and one requirement notice for production of information and documents issued pursuant to subsection 231.2(1) of the *Act*. The taxpayer argued that all four requirements were unreasonable or inappropriate.

The facts in this case are shocking. The taxpayer was audited by the CRA for the 1996 through 1998 taxation years with respect to management fees paid by a company, Thistlefield Ltd., during its 1997 and 1998 taxation years. The Minister issued notices of reassessment disallowing the deductions of the Thistlefield fees and the Appeals Division of the CRA reversed the decision of the auditor, Mr. Sayson. Mr. Sayson then conducted an audit of the 1999 and 2000 taxation years of the taxpayer and again denied the Thistlefield fees. He also denied certain deductions taken by the taxpayer with respect to the payment of a non-resident director's fee and

a management fee paid to a company known as "Sedko". Mr. Sayson sought direction from the CRA International Tax Directorate and an individual in that group suggested that it would be fruitless for Mr. Sayson to pursue a reassessment of the 1999 taxation year given the results for the earlier years. Mr. Sayson wrote a number of letters and exchanged correspondence with the accountant for the taxpayer and was provided with answers on a number of occasions to questions relating to Thistlefield, the non-resident director and Sedko. The taxpayer filed a notice of objection with respect to the 1999 notice of reassessment which Mr. Sayson proceeded to issue when disallowing the deduction of the Thistlefield fees once again and the non resident director and Sedko fees. Mr. Sayson then proceeded to commence an audit of the taxpayer's 2001 taxation year after the filing of the notice of objection with respect to the 1999 taxation year. On October 6, 2003, a senior official of CRA, through the prompting of Mr. Sayson, issued the four requirement letters, three of which were for foreign-based information and documents. The requirement notices required extensive information and asked questions which had previously been put to and answered in writing by the taxpayer and its representatives. There were also different compliance dates for the requirement notice under subsection 231.2(1) than for the three notices issued under subsection 231.6(1). The taxpayer sent the information required by the CRA but, in a cover letter, outlined in great detail how the same questions had been asked over and over again and how they had been and were being answered adequately.

The taxpayer asked the CRA to withdraw the requirements or to confirm that there had been substantial compliance. CRA refused to do either. The taxpayer, therefore, sought to challenge the four requirement notices and to have them set aside or varied on the following grounds:

- Questions had been previously asked by the CRA and answered by the taxpayer; and

- The taxpayer had substantially complied with the foreign-based and domestic requirements and, therefore, the requirement letters were unreasonable and inappropriate.

Madam Justice Dawson concluded that the four requirement notices should not be set aside. She first held that the requirements were issued to obtain information or documents relevant to the administration or enforcement of the *Act*. Second, she determined that the requirement notices for foreign-based information or documents under Section 231.6 were not unreasonable. In reaching conclusions regarding relevance for administration and enforcement of the *Act*, Madam Justice Dawson followed the jurisprudence from the Supreme Court of Canada in *James Richardson & Sons v. MNR* [1984] 1 S.C.R. 614 and *McKinlay Transport*, supra.

Madam Justice Dawson further summarized the principles with respect to domestic requirements issued under Section 231.2 of the Act as follows:

> "1. The determination of a taxpayer's tax liability is a purpose related to the administration or enforcement of the Act;
>
> 2. In order for a requirement to produce records to be valid, the Minister need not show the records will be relevant; he need merely show the records requested may be relevant;

> 3. Relevance is tested by determining whether the particular record requested may be relevant in the determination of a taxpayer's tax liability and not whether the particular record requested is relevant with respect to a particular issue under audit."

She proceeded to apply these principles and the statement of the Federal Court of Appeal in *MNR v. Kitsch et al.* 2003 D.T.C. 5540 that there is a low threshold for the determination of relevance relating to administration or enforcement of the *Act*. She concluded that the taxpayer's tax liability was under investigation at all times and that the foreign-based and the domestic requirement notices requested information that might be relevant to the determination of that liability. She further stated that the provision by the taxpayer of answers to the requirements could not then prompt the taxpayer to argue that the information was not relevant or unreasonable.

The interesting portions of the judgment, however, relate to the Court's analysis of whether the requirements were nonetheless unreasonable or inappropriate in the circumstances. The taxpayer argued that the requirement notices reflected a less than an objective attitude towards the taxpayer by the auditor and that the requirement letters were issued by the Audit Division after the audit activities had concluded with respect to the relevant taxation years. As such, it appeared that the timing of the issuance of the requirements was not an act which seemed to further the administration or enforcement of the Act by the Audit Division. Further, the taxpayer suggested that the requirement letters sought information previously provided repeatedly to the CRA and that the use of the 62 day period for requesting information under the domestic requirement notice circumvented the request for the same information set out in the foreign-based requirement notice and demanded within a 92 day period.

After reviewing the evidence, Madam Justice Dawson concluded that Mr. Sayson, the tax auditor, did not believe the taxpayer had provided complete or adequate information or documentation. She concluded that the CRA auditor believed that the documentary evidence which he would normally expect to exist was not provided and that he did not believe that the Thistlefield fees were deductible, notwithstanding the contrary decision of the Appeals Division with respect to the earlier taxation years. On balance, the Court was not satisfied that the CRA auditor was acting for any improper purpose or that he was overzealous and that the position set out in the CRA's auditor's audit report and in letters to the taxpayer was at least as consistent with a tenacious adherence to duty on the part of the CRA auditor as with any personal vendetta, spitefulness or overzealousness. Therefore, she concluded the evidence failed to establish the auditor was motivated by any improper purpose. At the same time the Court also recognized that the Minister had failed to file any affidavit evidence from the CRA auditor during the judicial review proceedings. Madam Justice Dawson concluded that the consequence of this action was to insulate the auditor from cross-examination. Unfortunately, the Court declined to draw an adverse inference from the failure of the CRA auditor to testify because she concluded that there was no *prima facie* case made out by the taxpayer that the CRA auditor was improperly motivated. This conclusion is extremely important because CRA, as a matter of course, can and will now serve requirement notices without fear of challenge. If no affidavit evidence needs to be filed by the Crown, the taxpayer will have extreme difficulty demonstrating that the CRA auditor had any improper purpose when issuing the requirement notice if deprived of the ability

or opportunity to cross-examine the CRA auditor on affidavit evidence as to the reasons for issuing requirement notices.

Madam Justice Dawson also concluded that the principles in the *Merko* decision should be followed with respect to the concept of "reasonableness". She stated that the requirement notices were not unreasonable in the circumstances because they were for the purpose of administering and enforcing the Act rather than to harass the taxpayer. She further concluded that the determinative fact in issuing a requirement was that no other requirements had previously been issued to the taxpayer asking the same questions. Even though the CRA auditor had asked questions repeatedly and been given the answers by the taxpayer, the Court decided that the Minister had no way of knowing whether the information provided by a taxpayer represented all of the information requested or all of the information relevant to the determination of the taxpayer's liability. Therefore the Minister's proper means of compelling a taxpayer to provide all such information or documents was through the issuance of a requirement notice. In support for this conclusion, Madam Justice Dawson quoted, with approval, the comments of Mr. Justice Rouleau in *Saipem* and stated that:

> "I find nothing unreasonable in their issuance simply because much of the information sought had previously been provided by the applicant."

Madam Justice Dawson also went on to make further conclusions with respect to the distinction between domestic and foreign-based requirements and with respect to a taxpayer's need to comply with foreign-based requirements:

- It is a complete answer to the need to observe a foreign-based requirement for the taxpayer to say that it does not have and cannot provide information or documentation because it is only in the possession or control of an unrelated person. A foreign-based requirement does not require production of information or documents in the possession or control of an unrelated person. In this situation, the concept of "unreasonableness" is not relevant. She therefore rejected the comments from the taxpayer that a foreign-based requirement which seeks information or documentation from an unrelated non-resident person is unreasonable. The taxpayer had alleged that the persons about whom the questions were directed in the requirement notices were dealing at arm's length and that certain information lay with such persons.

- By using a foreign-based requirement, it is not unreasonable for the Minister to commit the taxpayer to the position that it has no foreign-based information even from unrelated non-resident persons.

- It is not appropriate for the Federal Court, on an application for judicial review of a requirement notice under subsection 231.6(5) of the *Act*, to issue a declaration of "substantial compliance", a concept which is referred to in subsection 231.6(8) of the *Act*. There is no independent means for the Federal Court on a judicial review to verify the accuracy of the evidence that there has been substantial compliance. The proper forum for the determination of substantial compliance is when, in any civil proceeding relating to the administration or enforcement of the *Act*, the taxpayer attempts to

introduce into evidence any information or document which the Minister believes was covered by the foreign-based requirement notice.

2.7.3 Will Anything be "Unreasonable" for Purposes of Subsection 231.6(5)?

Based on the findings in these two decisions, the threshold for the relevance of documents for purposes of administration and enforcement of the *Act* will continue to be low. Furthermore, in all cases decided to date under Section 231.6, the contents of foreign-based requirement notices have been found to be reasonable. Based on the comments in *Saipem* and *1144020 Ontario Ltd.*, the following chart perhaps best summarizes what may be reasonable or unreasonable for purposes of future review of requirement notices issued under Section 231.6:

Reasonable	**Unreasonable**
1. Requiring for inspection of **all** corporate documents for the purpose of conducting an audit.	1. If the information sought and the reasons for the request have no rational connection.
2. Notice of requirement which calls for the disclosure of names and partnership interests of other members of an offshore partnership. (*Bernick*)	2. If all the information has already been provided under a requirement, any further requirement for the same information.
3. Requesting the same information that has already been provided (not under a notice of requirement).	3. "An abuse of process."
4. Timing of the requirement:	
(a) Notice of requirement issued after a notice of objection has been issued or the taxpayer seeks relief in the courts.	
(b) Notice of requirement issued after conclusion of Appeals Division determination	4. If the requirement is confined to a specific issue for a statute barred tax year.
5. Requesting information from past years. Notice of requirement need not be specific to certain years.	
6. Notice of requirement may request documents that are only in control of an unrelated person.	
7. The Minister may commit the taxpayer to a position that it does not have foreign controlled documents.	

3. Search and Seizure - Section 231.3

Search warrants are generally used by tax authorities to obtain information that may prove the commission of an offence under the *Act*. One must assume that the exercise of this power will likely be followed by assessments and prosecutions. However, the constitutional validity of this power was called into question by the decision in *Baron v. The Queen* 93 D.T.C. 5018 (S.C.C.). Consequently, subsection 231.3(3) was amended as of June 15, 1994 to remedy the previous deficiency. Canada Revenue Agency may also attempt to use the provisions of the *Criminal Code* as a means to effect a seizure, though the constitutional validity of section 488.1 of the Code has been questioned and successfully challenged (*Lavallee* 2002 SCC 61).

3.1 Who May Search And Seize?

Those eligible to search and seize are persons named in the search warrant granted by a Judge (of the Federal Court or provincial superior Court) on an *ex parte* application by the Minister, the Deputy Minister, Assistant Deputy Minister or other persons to whom the Minister's authority has been delegated under subsection 220(2.01). Those present usually include members of the Special Investigations Unit and one or more officers of the RCMP.

3.2 What May Be Seized?

The following is a list of what may be seized:

- any document or thing that may afford evidence as to the commission of any offence under the *Act*;
- any other document or thing believed, on reasonable grounds, to afford evidence of the commission of an offence under the *Act*, even if not mentioned in the warrant.

Copies of seized documents may be made with certified copies able to serve as evidence of the original with the same probative force.

3.3 Where May The Search And Seizure Take Place?

Under subsection 231.3(1), the search may occur in "any building, receptacle or place". The warrant, however, must identify these places that are to be searched.

3.4 From Whom May The Documents Or Things Be Seized?

No person may be searched. The person from whom any document or thing is seized is entitled, at all reasonable times and subject to such reasonable conditions as may be advised by the Minister, to inspect the document or thing and obtain one copy of the document at the expense of the Minister.

3.5 How And When May The Search And Seizure Be Made?

The *Act* is silent on this issue and the relevant limitations so common law principles governing search and seizure would apply. Some of these principles are set out in point form below. It is important, however, to note that Section 231.3 is not limited by phrase "at all reasonable times". Canada Revenue Agency must also not seize then search. In *Re Romeo's Place* 81 D.T.C. 5295 (F.C.T.D.) and *Kelly Douglas & Co v. The Queen* 82 D.T.C. 6036 (B.C.S.C.), the Court held that Canada Revenue Agency must first search for documents that are relevant in proving a tax violation whether or not particularized in the authorization.

The following represents some of the issues considered by the Courts in this regard:

- The warrant must be in the possession of the officer searching. But it need not be on his person.

  Codd v. Cabe (1875-76), L.R. Ex. Div. 352;
  Regina v. Purdy, [1975] Q.B. 288; (1974), 3 W.L.R. 357 (C.A.).

- The officer can use "reasonable force".

  Savinkoff v. Borodula (1957), 120 C.C.C. 165 (B.C.S.C.).

- Unlawfully obtained evidence is admissible at common law. However, under the *Canadian Charter of Rights and Freedoms*, evidence obtained in contravention of the *Charter* is inadmissible if its admission would bring the administration of justice into disrepute.

  R. v. Cohen (1983), 5 C.C.C. (3d) 156, 148 D.L.R. (3d) 78, 33 C.R. (3d) 151; *R. v. Bent* (1987), 79 N.S.R. (2d) 169 (N.S.C.A.); *R. v. Collins* (1987), 74 N.R. 276 (S.C.C.); *R. v. Genest* (1989), 91 N.R. 161 (S.C.C.).

- But for any requirement in the *Act*, the name of the owner of the articles sought and the name of the accused need not be mentioned.

  R. v. Trottier (1966), 4 C.C.C. (Que. Q.B.); *Marlboro Mfg. v. Queen* (1972), 16 C.R.N.S. 338 (Man. Q.B.).

- The warrant may be addressed to some authorized individual (usually a peace officer) or group of individuals (e.g. a police force).

  R. v. Solloway & Mills (1930), 53 C.C.C. 271 (Ont. S.C.); *Re Flanagan and Morand* (1979), 43 C.C.C. (2d) 546 (Que. S.C.).

- A statement of the time of the offence should be particularized.

  R. v. Read [1966], 2 C.C.C. 137 (Alta. S.C.).

- "... A lawyer's client is entitled to have all communications made with a view to obtaining legal advice kept confidential".

  Descoteaux v. Mierzwinski (1983), 44 N.R. 462 (S.C.C.).

- "The existence of a search warrant does not confer any special obligation on occupants to answer questions. Simple refusal to answer questions does not amount to obstruction."

  Fontana, *The Law of Search Warrants in Canada* (Toronto: Butterworths 1984) at page 211

- There is nothing in general terms which authorizes the use of a search warrant to search the "person" of an individual except for the specific provisions regarding the search for an offensive weapon. However, once arrested, a person may be searched.

  Fontana, at page 213

- Execution "by night" except in the case of gaming houses, is invalid unless the search warrant is endorsed with the authority "by night".

  R. v. Lukich (1946), 87 C.C.C. 83 (Alta. C.A.).

- Where the warrant authorizes the entry, search and seizure and states a time period for the entry, search and seizure all entry, search and seizure activities must be concluded within that time period. Any entry, search and seizure activities after the time period on the warrant are invalid.

  Pars Oriental Rug Bazaar v. A.G. Can. (unreported, B.C.S.C., August 15, 1988)

- The *Criminal Code* may be used for customs searches and Income Tax searches.

  Re Attorney-General of Canada and Doer (1979), 49 C.C.C. (2d) 533; *Dynacomo Business Computers Ltd. v. The Attorney-General* (1985), 15 W.C.B. 94 (B.C.C.A.)

- The informant in a search warrant, if he is a peace officer, may execute his own search warrant.

  Savinkoff v. Borodula (1957), 120 C.C.C. 165 (B.C.S.C.)

- Where a search warrant is issued by a Justice having jurisdiction in one territorial division, it must be endorsed by a Justice having jurisdiction in the territorial jurisdiction where it is to be executed. An officer executing a search warrant from another territorial jurisdiction that has not been "backed", is in the same position as one who makes a search with no right at all to do so.

  R. v. Compton (1828), 5 Q.B.C. 341

- A higher standard is required in cases of a search of premises of a third party not implicated in the offence. There can be no examination of files that have no relation to charges set out in the warrant.

  Shumiatcher v. Attorney-General of Saskatchewan (1960), 129 C.C.C. 267.

- The occupant of premises to be searched is entitled to resist or eject the officer when it can be said that the officer is not "cloaked" with lawful authority and is therefore not acting "in the execution of his duty". Because illegally obtained evidence may be admissible, it becomes very important to determine whether or not to resist, having in mind the question of:

  (a) validity of the warrant;

  (b) method of entry;

  (c) time of entry;

  (d) propriety of seizures.

- There can be no presumption of obstruction simply because the door is found locked. Obstruction requires some positive act of interference, or a refusal to do some act required to be done by statute. There is no obligation generally on the part of the citizens or suspected persons to assist police officers in discovering evidence upon which to convict.

  R. v. Jungle (1913), 22 C.C.C. 63; *R. v. Semeniuk* (1955), 111 C.C.C. 370.

- Those parts of the search warrant which are found to have been improperly described or made out are severable and their invalidity does not mean that a warrant not otherwise defective is invalid.

  Re Alder and The Queen (1977), 5 W.W.R. 132, (1977), 37 C.C.C. (2d) 234 (Alta. S.C.).

- There must be a search for "specified evidence", not entry merely to see what the evidence, if any, might be.

  Re Bell Telephone Co. of Canada, [1947] O.W.N. 651, 4 C.R. 162, 89 C.C.C. 196 (Ont. H.C.).

- Where a search is illegal there is no need to apply to have warrant quashed if the only issue is admissibility.

  R. v. Zevallos (1987), 37 C.C.C. (3d) 79 (Ont. C.A.).

3.6 What Are the Preconditions to Search and Seizure?

A warrant in writing under Section 231.3 may only be issued by a Judge upon satisfaction of the following conditions:

- the application must be supported by information on oath establishing the facts on which it is based;
- a Judge must be satisfied that there are reasonable grounds to believe that:
  - an offence under the *Act* was committed;
  - a document or thing that may afford evidence of the commission of the offence is likely to be found; and
  - the building, receptacle or place specified in the application is likely to contain such a document or thing; and
- the warrant must refer to the offence for which it is issued, identify the building or other place to be searched and the person alleged to have committed the offence and it must be reasonably specific as to any document or thing to be searched for and seized.

There is also no right to appeal the issuance of a search warrant by a trial Judge. The taxpayer's remedy is to attack the validity of the warrant at trial.

3.7 For What Period May the Seized Documents or Things Be Retained?

The Minister is required to bring the material seized, or to make a report in respect thereof, before the Judge who issued the warrant for a determination as to the Minister's right to retain the material. Under subsection 231.3(5), this includes other documents or things seized on reasonable grounds that it affords evidence of an offence under the *Act*. A Judge shall, unless the Minister waives retention, order that it be retained by the Minister. The Minister (or others) shall then take reasonable care to ensure that it be preserved until the conclusion of any investigation into the offence in relation to which the document or thing was seized or until it is required to be produced for a criminal proceeding (subsection 231.3(6));

Under subsection 231.3(7), the Judge may, however, on his own motion or that of an interested party, order that some or all of the seized material be returned where it was improperly seized or is not required for an investigation or for a criminal proceeding.

3.8 What Are The Penalties For Non-Compliance?

There are penalties within the *Act* for failure to comply. The affected party must not hinder, molest or interfere with persons authorized to search, seize or copy seized documents or prevent or attempt to prevent such actions. Otherwise there are penalties under subsection 238(1) resulting in summary conviction with liability for a fine and a possible term of imprisonment. Once again, exceptions exists for solicitor-client privilege or the inability of the party to comply.

4. Inquiry: Section 231.4

Inquiries are infrequently used though they are now apparently becoming more popular as means of extracting information from unwilling taxpayers or third parties. This resolve is likely strengthened by a 1989 Court decision which determined that the concept of an "inquiry" did not infringe the *Canadian Charter of Rights and Freedoms* or the *Canadian Bill of Rights* (*462657 Ontario Ltd. v. MNR* 89 D.T.C. 5445 (F.C.T.D.)). Canada Revenue Agency may also use the inquiry as a means to "discover" the taxpayer once the taxpayer has appealed to the Tax Court of Canada.

4.1 Who May Authorize A Person To Make The Inquiry?

The Minister or others authorized under subsection 220(2.01) may do so.

4.2 Who May The Minister Authorize To Make An Inquiry?

The inquiry may be conducted by any person, whether or not an Canada Revenue Agency official.

4.3 Grounds For Commissioning An Inquiry

The inquiry must deal with anything relating to "administration and enforcement of the [Income Tax] *Act*". It need not (at least expressly) involve an investigation of a specific person or persons or a verification of compliance with the *Act* by identifiable persons. The case law, however, may suggest otherwise.

4.4 Who Will Chair The Inquiry?

Under subsection 231.4(2), the Minister must apply to the Tax Court of Canada for an order appointing a hearing officer before whom the inquiry will be held.

4.5 Mechanics Of Inquiry

The mechanics of the inquiry are set out in subsections 231.4(5) and (6). The powers of hearing officers are set out in Sections 4 and 5 of *Inquiries Act* and relate to summoning witnesses and documents. Any person giving evidence has the right to be represented by counsel and may, upon request, receive a transcript of the evidence given by him. The hearing officer shall not exercise the power to punish any person unless, on application by a hearing officer:

- a Judge of a superior Court or county Court certifies that the power may be exercised in the matter disclosed in the application; and

- the applicant has given to the person, in respect of whom he proposes to exercise the power, 24 hours notice of the hearing of the application or such shorter notice as the Judge considers reasonable. Principles of natural justice, however, may not apply because the hearing is purely administrative in nature.

4.6 The *Del Zotto* Inquiry

An example of the use of these provision is contained in *Angelo Del Zotto v. MNR* 93 D.T.C. 5455 (F.C.A.). In that case, the Tax Court of Canada appointed a hearing officer under subsection 231.4(2) to preside over an inquiry into the affairs of the taxpayer. The taxpayer applied to the Federal Court of Appeal for an order setting aside the decision of the Tax Court. Although invited to do so, the taxpayer declined to challenge the inquiry on *Charter* grounds. As a result, the Court of Appeal followed the decision in *Guay v. Lafleur* [1965] 2 S.C.R. 12, which held that an inquiry was an administrative function for which their was no judicial review. At page 5457, the Court of Appeal stated:

> "Viewed in this light, and absent any *Charter* challenge, it is clear that the application must fail. None of the grounds that were argued have any merit: the applicant had no right to notice of or to participate in the application made to the Tax Court for the appointment of a hearing officer under subsection (2). That application was subject to no requirements as to form and it was for the Tax Court judge alone to decide if the materials before him were sufficient to allow him to exercise the powers conferred on him by the statute; if he thought they were not it was open to him to require further materials or even to dismiss the application. Furthermore, while it would be difficult to characterize the period of over six weeks which elapsed between the ministerial authorization under subsection (1) and the application to the Tax Court under subsection (2) as being "forthwith", we are satisfied that in the absence of any showing of prejudice by the applicant, and there was none, such defect does not give rise to the nullity of the appointment."

The inquiry was stayed on two occasions. First, so the taxpayer could challenge the inquiry on non-*Charter* grounds (rejected, see above) and second so that the taxpayer could challenge the inquiry on *Charter* grounds (see 94 D.T.C. 6170). The procedural wrangles continued in 96 D.T.C. 6222 (F.C.A.) and the Federal Court Trial Division determined that section 231.4 was constitutional (97 D.T.C. 5145). The Federal Court of Appeal (97 D.T.C. 5328) overturned this decision and ruled it violated the Charter. The Supreme Court of Canada determined that the Charter had not been violated through the passage of this provision. The litigation continued (December 7, 1999 and March 22, 2000) regarding rulings of the Hearing Officer under section 231.4.

5. Limitations On The Disclosure of Information By The Public

5.1 Overview

The enforcement powers available to Canada Revenue Agency under the *Act* are extensive. At first glance, one would expect that the particular rights of taxpayers would be affected by the exercise of these powers notwithstanding the procedural safeguards built into these statutory powers by Parliament. The *Act* contains statutory limitations which would exempt taxpayers and other persons from disclosing information to taxation authorities. In addition, the Courts have protected taxpayers and relieved them from disclosure requirements in circumstances where there was insufficient compliance with the statute or where other competing public interests favoured such relief.

5.2 Statutory Limitations Within The *Act*

5.2.1 Exemptions From Reporting and Records Destruction

The *Act* relieves taxpayers from making certain disclosures. For example, under section 150 individuals are exempt from filing tax returns to the extent there is no tax payable for a taxation year. The taxpayer is permitted to destroy books and records after having secured the permission of taxation authorities in some circumstances (see section 230). Permission is not even required in all circumstances.

5.2.2 Solicitor-Client Privilege

Section 232 of the *Act* contains deals with "solicitor-client privilege". The *Act* permits a lawyer to defend against prosecution for failure to comply with the requirement to disclose information or to produce a document in the event of search and seizure on the basis that solicitor-client privilege was believed to exist on reasonable grounds and was claimed. Under subsection 232(1) certain documents, however, that are considered "the accounting record of a lawyer" cannot be the subject of privilege. Section 232 of the *Act* contains procedural codes for privilege claims. The right of a client to claim privilege in respect of communications with third parties or with legal counsel is a common law proprietary right which the statute acknowledges and facilitates. Further discussion regarding the nature of solicitor-client privilege and its parameters are set out in greater detail below.

Section 488.1 of the Criminal Code has a similar wording to section 232. Three 2002 decisions of the Supreme Court of Canada held it to be unconstitutional (*Lavallee, White* and *Fink* 2000 SCC 61). The court found that the section inadequately protected solicitor-client privilege in a search of law offices.

5.3 Statutory Limitations Outside Of The *Act* - The Canadian Charter of Rights and Freedoms

Much has been written about the impact of the *Charter*. Taxpayers have not been consistently successful in invoking various provisions of this document to prevent the infringement of certain fundamental rights and freedoms. In many cases the Courts have neither struck down tax legislation that offended the *Charter* nor adopted a more flexible and carefully tailored approach

as they have done in other circumstances. Yet, there are a number of other decisions that warrant mention. The *Baron* case (discussed above) determined that a former version of Section 231.3 of the *Act* was unconstitutional because it gave no discretion to a Judge regarding the issuance of a search warrant and it constituted unreasonable search and seizure prohibited by Section 8 of the *Charter*. The Federal Court of Appeal determined in *Tyler v. MNR* 91 D.T.C. 5022 (F.C.A.) that the requirement exercised under Section 231.2 of the *Act* did not amount to a "seizure" contrary to Section 8 of the *Charter* and there was no infringement of paragraph 11(c) of the *Charter* relating to self-incrimination. The Court held that in a tax audit there is no suspect and no accused and the "requirement procedure" is entirely administrative. However, Charter rights can be engaged in certain circumstances. For example, the three cases (*Lavallee, White, Fink*) mentioned above determined that section 8 had been infringed and that could not be justified under section 1 of the Charter. The Supreme Court of Canada also determined in *Jarvis* [2003] 1 C.T.C. 135 that the Minister cannot use audit powers where the predominant purpose was to investigate as opposed to audit. This was followed in *Stanfield* 2005 D.T.C. 5454 (F.C.) and *Ellingson* 2005 D.T.C. 5492 (F.C.A.). See also *Schiel* (B.C. Prov. Ct. – October 28, 2005) and *Thompson* 2005 D.T.C. 5055 (B.C. Prov. Ct.) and *Murphy* 2009 F.C. 1226).

5.4 Intervention By The Courts

The Canadian Courts have favoured the rights of the taxpayer over the powers of tax authorities to protect privileged communications and to ensure strict compliance with the procedural requirements of the *Act*. Unfortunately, these Court applications are sometimes time-consuming and costly and may, in some circumstances, have already resulted in the viewing by the tax authorities of information or documents that may ultimately prove damaging.

5.4.1 Strict Compliance With The Procedural Requirements of the *Act*

The earlier narrative on the investigatory powers of Canada Revenue Agency under the *Act* demonstrates various procedural safeguards that officials must observe before undertaking to exercise these powers. The following may result in non-compliance with statutory requirements:

- unreasonable time limit for requiring the provision of information;

  Licht, Joseph (above)

- inaccurate or untruthful affidavits sworn in support of an *ex parte* application to obtain a search warrant;

  Hellenic Import-Export Co. Ltd. v. MNR 87 D.T.C. 5213 (B.C.S.C.).

- information collected or sought to be collected that does not relate to the administration or enforcement of the *Act* but is the product of a "fishing expedition";

  R. v. Bruyneel 86 D.T.C. 6119 (B.C.C.A.); *James Richardson & Sons v. The Queen* 82 D.T.C. 6204 (F.C.A.); and *Bank of Commerce v. A-G Canada* 62 D.T.C. 1237 (S.C.C.)

- excessive searching outside the scope of the warrant;

  Re Romeo's Place 81 D.T.C. 5295 (F.C.T.D.) and *Kelly Douglas & Co. v. The Queen* 82 D.T.C. 6036 (B.C.S.C.)

- failure to serve or deliver the requirement in a proper manner;

  Robins v. Forbes 1 D.T.C. 8 (Sask. K.B.).

Search warrants may prove defective if there is non-compliance in the following circumstances:

- The warrant must properly describe the items to be searched for.

  R. v. Comic Legends (1987), 56 Alta. L.R. (2d) 170, 83 A.R. 107, 40 C.C.C. (3d) 203 (Alta. Q.B.)

- In the case of documents the time period specified for the documents to be seized must not be excessive.

  R. v. Sarnia Home Entertainment Library Ltd. (1984), 4. C.R.D. 850. 50-09; *Re Dobney Foundry Ltd. et al. and The Queen (No.2)* (1985), 19 C.C.C. (3d) 465.

- In the case of documents the warrant must describe the documents sufficiently such that the searching officer can ascertain those documents authorized by the search.

  Re United Distillers Ltd. (1946), 88 C.C.C. 338 (B.C.S.C.).

- The search warrant must describe the place to be searched.

  R. v. Yoo (1986), 78 A.R. 76 (Alta. Q.B.).

- The search warrant must be instructive and directive as to the search power contained in warrant.

  Dergousoff and R., Re (1984), 10 C.R.R. 186 (B.C.S.C.).

- Search warrants cannot be too broad in their scope as to what to search.

  C.D.N. Newspapers Co. v. Canada (A.G.) 1986, [1987] 1 W.W.R. 262, 28 C.C.C. (3d), 31 D.L.R. (4th) 601 (Man. Q.B.).

- The search warrant must describe the real reason for the search.

  R. v. Caron, (1982), 31 C.R. (3d) 255.

- The issuing Judge must have before him the information to indicate that other reasonable sources of desired information have been explored and exhausted.

  Cleaver and Wakinshaw Ltd. v. British Columbia (1986), 1 B.C.L.R. (2d) 186, 26 C.C.C. (3d) 246 (B.C.S.C.).

- There must be sufficient facts before the Judge to evidence a factual basis of the commission of a crime.

  R. v. Christensen (1986), 47 Sask. R. 143, 26 C.C.C. (3d) 391 (Sask. Q.B.).

- The offence must be disclosed and the offence must be known to law.

  R. v. Guilles (1985), 25 C.R.R. 273 and *Capostinsky v. Olsen* (1981), 27 B.C.L.R. 97 (S.C.).

- The source of the information must be disclosed or the police officer has sworn a belief in the truth of the information.

  R. v. Savory (1985), 65 A.R. 201 (Alta. Q.B.).

- Grounds for the informant's belief are sufficiently set out in the information.

  R. v. Christenson (1986), 47 Sask. R. 143, 26 C.C.C. (3d) 391 (Sask. Q.B.).

- The warrant must sufficiently set out the relationship between the items to be searched for and the offence.

  Chapman and R., Re 46 O.R. (2d) 65 (Ont. C.A.);

- A Judge must act judicially in issuing the warrant, that is, the Judge relies on the assurances of the informant instead of making a judicial decision. For example, the Judge must be satisfied as to reasonable and probable grounds, and the Judge must make enquiries into the nature of the officer's grounds for belief.

  R. v. Moran (1987), 21 O.A.C. 257 (C.A.) and *R. v. Harris & Lighthouse Video Centers Ltd.* (1987), 57 C.R. (3d) 356 leave refused (1987), 35 C.C.C. (3d) 1 and *Cooper v. Kerwin* (1982), 38 Nfld. and P.E.I.R. 446, (P.E.I.S.C.).

- Any amendments to the warrant must be given with reasonable and probable grounds and under oath. This principle extends to changing the time of the search or changing the date of the search.

  R. v. Jamieson (1989), 48 C.C.C. (3d) 287 (N.S.C.A.).

- The warrant must have the names of the informants edited out.

  R. v. Strzelecki (1989), 15 C.R.D. 850. 50-08

- The jurisdiction of the Court to issue the warrant must be made apparent on its face.

  R. v. McHugh (1907), 13 B.C.R. 224, 13 C.C.C. 104 (B.C.S.C.).

- There are no fatal errors on the information such as:

- The date of the information is later than the date of the warrant;

  Nadeau c. Lalande, [1984] R.L. 440 (C.S. Que.).

- The information was not signed (and in which no grounds of information and belief were disclosed);

  Roux v. Hewat, [1919] 1 W.W.R. 530 (B.C. Co. Ct.).

- There is material non-disclosure;

  R. v. Sismey, (1990), 55 C.C.C. (3d) 281 (B.C.C.A.).

- The issuing Justice or Judge must add "Justice of the Peace", "Judge" or signing authority to the issue of the warrant;

  R. v. Black [1973] 6 W.W.R. (3d) 371 (B.C.S.C.).

- The warrant cannot purport to authorize seizure of objects that are not set out in section 230 of the *Act*;

- The proper form must be used. (i.e. the warrant is issued using the form for a *Food and Drug Act* search but should have been issued using the form for a *Narcotics Act* search);

  R. v. Legault (1985), 6 C.R.D. 850. 50-04; *R. v. Renald* (1987), 12 C.R.D. 850. 50-06.

- The Justice of the Peace or Judge must be neutral and impartial (i.e. the Justice of the Peace cannot work under the commanding officer of the office asking for the warrant).

  R. v. Magee, [1980] 13 W.W.R. 169 (Alta. Q.B.); *R. v. Baylis* (1988), 66 Sask. R. 268 (C.A.).

- The search warrant must not be used for a second search.

  R. v. Christine (1982), 1 C.R.D. 850. 50.01.

- The police must know, at the time they ask for the warrant, that the subject of the search is there.

  R. v. Cameron (1984), 16 C.C.C. (3d) 240; *R. v. Bohn* (1987), 11 C.R.D. 850. 50-07; *R. v. Bucknor et al.* (1987), 10 C.R.D. 850 50-06.

5.4.2 Protection of Privileged Communications

Traditionally, "privilege" only extended to communication between solicitor and client. There is, however, case law that has arisen both in Canada and the United Kingdom within the last 30 years which suggests that the Courts may come to define a new head of privilege outside the traditional mode. For example, in *Slavutych v. Baker* [1976] 1 S.C.R. 254, the Supreme Court of Canada determined that the recipient of a confidential communication, namely the University of Alberta, could not use the communication against its author as a basis to support a charge of misconduct. In that decision the Supreme Court referred to a four-fold test enunciated by Wigmore, a learned authority on evidence, for the purpose of determining whether a communication should be considered as privileged. These four-fold tests are the following:

- the communication must originate in a confidence that they will not be disclosed;
- this element of confidentiality must be essential to the full and satisfactory maintenance of the relation between the parties;
- the relation must be one which in the opinion of the community ought to be "sedulously fostered";
- the injury that would inure to the relation by the disclosure of the communications must be greater than the benefit thereby gained for the correct disposal of litigation.

5.4.3 Protection of Correspondence in Contemplation of Settlement - Without Prejudice Communications

Letters exchanged by taxpayers and Canada Revenue Agency or their representatives may bear the notation "without prejudice". This phrase is sometimes misunderstood and misused.

The term "without prejudice to my position" is short for the term "without prejudice to my position at trial". The term is properly used only in the context of settlement negotiations and specifically when dealing with compromised positions. There are sound policy reasons to encourage parties to settle their differences without resorting to a trial or to court. Because settlement negotiations inevitably involve compromised positions, the courts encourage those communications, either written or oral, by protecting such communications from being introduced, in any manner, at trial.

However, three conditions must be present for the protection to arise. The first condition is that there is a litigious dispute in existence or at least in contemplation. The second condition is that the communication be made with the express or implied intention that it would not be disclosed to the court in the event that negotiations fail. The phrase "without prejudice" signifies that the

party making the assertion has such an intention. The courts have inferred that the whole of the correspondence, which includes the "without prejudice" communication, will be protected. The third condition is that the purpose of the communication must be to affect settlement. If the communications reveal another or broader purpose, neither the presence of the phrase "without prejudice" nor a litigious dispute will result in the communication being protected.

One of the leading cases on the admissibility of communication made on a without prejudice basis is *Corporation of the County of York v. Toronto Gravel Road and Concrete Co*. (1882), 3 O.R. 584 (Ch. D.). The Court stated the rule as follows:

> "The rule I understand to be that overtures of pacification, and any other offers of propositions between litigating parties, expressly or implicitly made without prejudice, are excluded [from evidence] on grounds of public policy."

The rule was subsequently confirmed in *Piri v. Wyld* (1886), 11 O.R. 442 (C.P.):

> "The authority seems, though not very numerous, to be clear upon the first point, that letters written or communications made without prejudice, or offers made for the sake of buying peace, or to affect a compromise, are inadmissible in evidence; It seemingly being considered against public policy as having a tendency to promote litigation, and to prevent amicable settlements."

The Court further stated that the rule protected both communications made in furtherance of a settlement and those expressing the writer's view on the matters in dispute.

The use of the words "without prejudice" do not determine whether a communication is inadmissible. The admissibility of the communication in evidence depends upon the intention of the parties, the existence of a dispute and the contents of the communication. Although the use of the term "without prejudice" is not determinative, it may be evidence of the intention of the writer to render the communication inadmissible.

Communications written to a second party are also inadmissible in a dispute with a third party. In *I. Waxman & Sons Ltd. v. Texaco Canada Ltd. et al*. (1968), 67 D.L.R. (2d) 295, aff'd 69 D.L.R. (2d) 543 (Ont. C.A.). a letter written to a second party was not admissible against the writer. The Court assessed the policy as being:

> "to encourage amicable settlements and to protect parties to negotiations for that purpose. It is in the public interest that [this protection] not be given a restrictive application."

In certain circumstances, however, communications intended to be excluded are admitted into evidence. Generally these circumstances fall within four categories.

- Communications Not Within The Rule: If the factual context in which the communication is made does not fit within the rule, then the communication will be admissible in Court.

Sidhu v. Grewal (1986), 70 B.C.L.R. 128 (B.C.S.C.).

- Offer Accepted: A without prejudice communication is admissible if the communication contained an offer and the offer is accepted by the party receiving the communication. The communication is admissible as proof of the offer.

  Sidhu (above)

- Threats: If the communication contains veiled threats, the letter will be admissible in order to show that a settlement was reached as a result of duress or undue influence.

  Underwood v. Cox (1912), 4 D.L.R. 66.

- Contents Prejudicial: If the communication in question is prejudicial by its very nature then it is admissible.

  Re Daintry ex. p. Holt, [1893] 2 Q.B. 116.

Most recently, in the U.K., the Court held that the "without prejudice" privilege covered not only technical admissions but also extended to information as to who broke off negotiations and who decided not to go through with an apparently agreed deal. Yet the privilege does not extend if there is bad faith in the negotiations (*Wilkinson v. West Coast Capital* [2005] E.W.H.C. 1606 (Ch.)).

For a recent discussion of "without prejudice" in a tax case, see *Woodland* 2009 T.CC. 434.

6. Solicitor-Client Privilege

The paper referred earlier to the significance of privileged communications. Clients wish to exercise the right of solicitor-client privilege to exclude the admission of information in evidence in Court proceedings and/or to prevent a party or authority adverse in interest such as Canada Revenue Agency from having the opportunity to review such information. For further information see Yaskowich, "Privilege: A Practical Discussion in a Cross-Border Context" 2006 CTF *Annual Tax Conference*, Chapter 23; Geddes, *The Fragile Privilege: Establishing and Safeguarding Solicitor-Client Privilege* (1999) 47 C.T.J. 799; Gamble and Sutcliffe, "Update on Attorney-Client Privilege in Canada", *Tax Notes International* (July 28, 2003) 23-28; Mahmud Jamal, *The Supreme Court of Canada on Solicitor-Client Privilege: What Every Practitioner Needs To Know* (CBA: On Line CLE, November 29, 2006).

6.1 What Is Solicitor-Client Privilege?

Solicitor-client privilege represents the right of a lawyer's client to confidentiality in certain circumstances. There are two quite different principles referred to as solicitor-client privilege:

(a) all communications, verbal or written, of a confidential character, between a client and a legal advisor directly related to the seeking, formulating or giving of legal

advice or legal assistance (including the legal adviser's working papers directly related thereto) are privileged; and

(b) all papers and materials created or obtained specially for the lawyer's "brief" for litigation, whether existing or contemplated, are privileged.

6.2 Legal Professional Privilege

The right of confidentiality is no longer merely a rule of evidence but a proprietary right available to the client. It may be raised in any circumstances where communications are likely to be disclosed without the client's consent. The Supreme Court of Canada determined in *Descoteaux v. Mierzwinski* (1983), 44 N.R. 462 that a client's right to confidentiality exists where legal advice of any kind is sought from a professional legal advisor in his capacity as such and the communications relating to that purpose are made in confidence by the client unless the client waives that protection. Consequently preventative action may be taken prior to the examination of any written materials to which privilege attaches notwithstanding the interest by a party adverse in interest in such materials.

6.3 Litigation Privilege (also sometimes called "Solicitor's Brief" privilege)

The leading and most recent decision is that of the Supreme Court of Canada in *Blank v. Canada (Minister of Justice)* [2006] 2 S.C.R. 319.

6.3.1 What Does It Cover?

This type of privilege can cover communications between various parties, including the solicitor and client, the solicitor and a third party, the client and a third party, and where the client is a company or other organization, between members of the company or organization, provided:

- the communication/documents under consideration must have been prepared in the course of or in anticipation of litigation; and

- the "dominant purpose" of preparing the communication must have been for the litigation. (See *General Accident Assurance Co. v. Chrusz* [1999] O.R. 3291.

See, also *Hamalainen v. Sippola* (1991), 62 B.C.L.R. (2d) 224 (C.A.)

This type of privilege will also apply to copies of documents, whether or not they were prepared in contemplation of litigation or that was the dominant purpose, and even if they are not otherwise privileged, which have been collected by the lawyer, exercising his/her legal knowledge, skill and judgment, in order to advise on or conduct litigation. See *Hodgkinson v. Simms* (1988), 36 C.P.C. (2d) 24 (B.C.C.A.).

In *Hunt v. T & N plc* (1992), 68 B.C.L.R. (2d) 133 (S.C.); aff'd (1993), 77 B.C.L.R. (2d) 391 (C.A.), Esson C.J.S.C. (as he then was) held that the only essential element to maintain privilege was that the decision to obtain the copies be made by the legal advisor for the purposes of the litigation. When this finding was challenged on appeal, Hinkson J.A. for the court accepted that "in a case of this magnitude it is self-evident that the solicitor who had assembled a collection of

relevant copy documents for his brief . . . must bring to his task a considerable degree of legal knowledge, skill, judgment and industry to accomplish his task" (at p. 397). See also *Mutual Life Assurance Co. of Canada v. Department of A.G. (Canada)* (1988), 28 C.P.C. (2d) 101 (Ont. H.C.J.).

If the original of a document in the client's possession is not privileged, it does not become privileged because a copy was sent to the client's solicitor and is part of the solicitor's brief: see *Mutual Life*, supra.

6.4 Privilege And Confidentiality

In his 1989 Canadian Tax Foundation paper, Jacques Bernier pointed out the distinction between these terms in the following excerpt (footnotes omitted):

> "The words 'confidential' and 'privileged' are sometimes used separately and sometimes together and, on many occasions, with great confusion. Confidentiality may be defined as one's obligation imposed by law or by contract not to disclose certain facts or information. Privilege has a more technical meaning, which focuses on the 'right of some person or the State, and conversely the duty of the witness, to withhold evidence otherwise relevant and admissible from a Court of law'."

The main distinction between confidentiality and privilege is that confidential communications are not per se privileged. This principle was first set out in *Wheeler v. Le Marchant*, where Jessel MR stated:

> "In the first place, the principle protecting confidential communications which a man must necessarily make in order to obtain advice, even when needed for the protection of his life, or of his honour, or of his fortune. There are many communications which, though absolutely necessary because without them the ordinary business of life cannot be carried on, still are not privileged. The communications made to a medical man whose advice is sought by a patient with respect to the probable origin of the disease as to which he is consulted, and which must necessarily be made in order to enable the medical man to advise or to prescribe for the patient, are not protected. Communications made to a priest in the confessional on matters perhaps considered by the penitent to be more important even than his life or his fortune, are not protected. Communications made to a friend with respect to matters of the most delicate nature, on which advice is sought with respect to a man's honour or reputation, are not protected. Therefore it must not be supposed that there is any principle which says that every confidential communication which it is necessary to make in order to carry on the ordinary business of life is protected. The protection is of a very limited character, and in this

country is restricted to the obtaining [of] the assistance of lawyers, as regards the conduct of litigation or the rights to property."

More recently, the rule that confidentiality does not constitute by itself an objection to the giving of evidence was restated by the House of Lords in *A. Crompton Ltd. v. Customs and Excise*. In the particular case of accountants, the absence of a privilege was recognized in *Chantrey Martin & Co. v. Martin*. In Canada, the rules are similar, except in Quebec, as we will see later.

Generally speaking, confidentiality represents an obligation imposed by law or by contract on a party not to disclose certain facts or information. In all professional engagements, there is an implied term that the affairs of clients are confidential and cannot be disclosed by the professional without the consent of the client. Failure to observe this requirement by an accountant or lawyer could result in disciplinary proceedings by the relevant professional body (See for example, the *Canadian Bar Association, Code of Professional Conduct*).

Although many relationships are intended to be confidential, the Canadian Courts (see in particular *Slavutych v. Baker* [1976] 1 S.C.R. 254) have determined that it is more important for them to decide a case properly and that the cause of justice is paramount in every case and must take precedence over the integrity of claims for confidentiality. Therefore, as the excerpt from Bernier indicated, newspaper reporters must reveal their sources; companies must disclose their trade secrets; doctors must divulge their records; and accountants must release their working papers.

The policy reason for the exception relating to solicitor-client privilege involves the determination that the protection of an individual's freedom is more important than the proper administration of justice. It is said that if the solicitor-client communication could be disclosed it would be impossible for a client to discuss a case with his lawyer, for a lawyer to represent the client and for justice to be done. This rationale is based on the more fundamental policies regarding protection against self-incrimination and the presumption of innocence until proven guilty. Overall, freedom is considered more important than justice.

6.5 Whose Privilege?

The solicitor-client privilege belongs to the client and not the lawyer. Should a lawyer not be able to contact a client to exercise that privilege then the lawyer has a duty to uphold that privilege even in circumstances where the client has been disengaged or has not paid past accounts. However, the privilege arises only during the life of the solicitor-client relationship and attaches to a particular communication even if the relationship may have been severed.

6.6 Where Can Privilege Be Claimed?

A solicitor-client privilege claim may be asserted at a lawyer's office, at a client's premises or depending, on the circumstances, at the offices of a third party such as an accountant. See for example *Zein et al. v. Deputy Minister of National Revenue, Taxation* 91 D.T.C. 5053 (B.C.S.C.)

6.7 Loss Of Privilege

As indicated above, there are certain prerequisites to a claim for solicitor-client privilege. For example, communications must be made in confidence and for the purpose of obtaining legal advice. Privilege was lost in *Re Klassen-Bronze Ltd. v. MNR* 70 D.T.C. 6361 (Ont. S.C.) because the communications were heard or seen by a third party. Only the holder of the privilege may waive it. Such waiver may be express or implied. For example, anyone, including a tax practitioner who discloses otherwise privileged information in the course of a voluntary disclosure, during negotiations with the Appeals Division of Canada Revenue Agency or in the audit process will have waived the privilege, if duly authorized to act on behalf of the client (See *Visser v. MNR* 89 D.T.C. 5172 (P.E.I.S.C.)).

In *Re Missiaen et al.*, [1967] C.T.C. 579 (Alta. S.C.), the Court held that no privilege attached to communications made to facilitate crime or fraud or when the communication involves information which might tend to establish the innocence of another person charged with a criminal offence. A mere allegation of fraud, however, is insufficient to set aside the privilege. A prima facie case of fraud must be made out before the claim of privilege is destroyed.

The decision in *Cineplex Odeon Corporation v. A.G. of Canada* 94 D.T.C. 6407 (Ont. Gen. Div.) contains a discussion on loss of privilege. In *Cineplex*, the taxpayer used KPMG Peat Marwick Thorne ("KPMG") for both its tax accounting and audit work. In the course of reviewing certain transactions undertaken by the taxpayer, Canada Revenue Agency seized five documents from the tax accounting files. Canada Revenue Agency argued that the privilege associated with the documents had been lost because the tax accounting team had given these documents to the auditors. The Court held that the privilege had not been waived by the taxpayer and as a result the documents were still protected by solicitor-client privilege. The Court concluded that privilege had not been waived for two reasons:

- the client did not consent to the disclosure. KPMG did not have the clients' authorization to give copies of the document to the auditors;

- the disclosure was inadvertent. The person who gave the documents to the auditor did not intend to waive privilege in the documents as she did not think that the privilege would be lost.

Although the taxpayer was successful in *Cineplex*, the case serves as a warning on how easy it can be to lose privilege. The Court specifically pointed out that if the auditors had received the same documents from the client then privilege would have been lost. Clients must therefore be instructed concerning any documents in their possession which may not be for Canada Revenue Agency's eyes. Perhaps a better plan is to make sure that documents in the client's possession do not contain damning tax analysis. Finally, memoranda containing tax analysis should be separated from those containing corporate or accounting steps. Documents which instruct others on work that needs to be done should be limited to the instructions. They should not contain the tax analysis. A letter to an accountant asking for Pro Forma financial statements after a reorganization should not include the tax analysis which supports the reasons for the reorganization. A similar conclusion was reached in *Interprovincial Pipeline v. MNR* 95 D.T.C. 5642 (F.C.T.D.), where the court discussed the concept of a "limited waiver".

This finding was recently affirmed in *Philip Services Corp. (Receiver of) v. O.S.C.* [2005] O.J. No. 4418 (appeal withdrawn). The Court noted at paragraph 47 that:

> "... disclosure to the auditors for their purposes is not properly disclosure to the world, because of the great importance of the solicitor-client privilege to the proper functioning of the legal system. The documents were sought by Mr. Kesler because Deloitte was the auditor and were given to him in that capacity. It would be contrary to the basis of the decisions in *Descôteaux*, supra, and *Lavallee*, infra, to extend the scope of that disclosure to the world. [Referring to the decisions of the Supreme Court of Canada in *Descôteaux c. Mierzwinski*, [1982] 1 S.C.R. 860, and in *R. v. Lavallee, Rackel & Heintz*, noted above.]"

Based on this, the Court held unanimously that the OSC had erred in finding that the giving of an otherwise privileged document to an auditor in the course of the audit of the public company constitutes "an unlimited waiver of the solicitor-client privilege" (para. 59). Instead, and with respect to a waiver made under the compulsion of the legislative and regulatory powers and obligations of the auditors, the Court stated:

> "In my view, there is no necessity, in order to achieve the societal objective of fair financial statements certified as fair by fully informed auditors, that the waiver go beyond the auditors. By definition, the waiver enables the auditors to comply with the full scope of their audit standards. To hold that the waiver is broader than that, is to sanction a more than "minimal impairment" of this privilege which is fundamentally important to our justice system. (para. 57)"

The Court also dealt with the question of whether the auditor could, in effect, waive the privilege of the company by its having released the documents to the staff from the OSC as follows:

> "Equally clearly, Deloitte had no authority to act as the agent of Philip to waive the privilege, which still attached to these documents in its possession. Philip gave Deloitte no specific authority to waive privilege. Nor can there be an implied authority, for the audit responsibilities of the auditor do not normally require the surrender of the client's privileged documents to third parties for their purposes and not for the purpose of the audit responsibilities of Deloitte. The mere possession of the documents did not carry the authority to waive the privilege. (para. 68)"

The Court wraps all of this together nicely with the following conclusion:

> "In summary, I conclude that all of the Disputed Documents were prima facie privileged; that the provision of copies to Deloitte in its

> capacity as auditor did not waive the privilege for all purposes, but only to the extent necessary to enable Deloitte to carry out its audit functions; that delivery by Deloitte to Staff of those documents received from Philip was unauthorized and incapable of defeating the privilege; that Staff has not established any implied waiver by Philip by reason of the evidence given in this proceeding by the respondents or by other former officers and directors of Philip as no one has asserted as yet that the Legal Opinions were relied on by him in deciding not to disclose the Waxman Issue; that the use of the Opinions by Staff in this proceeding and by Deloitte in other actions cannot be a waiver by Philip of its privilege or otherwise affect that privilege; and that, except for the Caisse Notes, all the Disputed Documents remain privileged and may not be used or relied on by Staff as matters stand at this time. The caveat just expressed is meant to make it clear that the developments during the hearing may alter the situation and may require rulings based on fresh developments. (para. 92)"

Thus, the Court protected the privilege after the fact, despite the failure of the corporation, its auditors, or the regulators to do so.

6.8 Common Interest Privilege

The common interest privilege protects legal advice obtained by one person who shares it with one or more others having a shared or similar interest. There is still relatively little Canadian authority on this issue. *General Accident, supra*, *Maritime Steel & Foundries Ltd. v. Whitman Benn & Ass. Ltd.* (1994), 114 D.L.R. (4th) 526 (N.S.S.C.), and *Supercom of California v. Sovereign General Insurance Co.* (1998), 18 C.P.C. (4th) 104 (Ont. Gen. Div.) are some of the few reported cases. The law is better developed in the U.S. The parties (e.g., defendants) asserting the common interest privilege cannot be adverse in interest in litigation. Once the parties become adverse in interest (e.g., if they issue third party notices against one another), subsequent communications between them will be subject to discovery.

The common interest privilege is not limited to litigation. It is available where no litigation is in existence or even contemplated. The privilege may be found where two parties (who are independently represented by counsel) are negotiating towards a mutually beneficial transaction. The economic and social values inherent in fostering commercial transactions merit the recognition of a privilege that is not waived when documents prepared by professional advisers for the purpose of giving legal advice are exchanged during the course of negotiations. For recent decisions on the topic of common interest privilege, see *Archean Energy Limited* 98 D.T.C. 6456 (Alta. Q.B.), *Pitney Bowes* (2003) (F.C.T.D.) and *Fraser Milner* (December, 2002) (B.C.S.C.).

In *Patrick v. Capital Finance Corp. (Australasia) Pty. Ltd.*, [2004] F.C.A. 1249, the court affirmed the rule "that after a conflict of interest has clearly been identified, common interest privilege will not apply" (para. 20). The court relied on *Lee v. South West Thames Regional*

Health Authority, [1985] 1 W.L.R. 845 and *Arnpolex Ltd. v. Perpetual Trustee Co. (Canberra) Ltd.*, (1995), 37 N.S.W.L.R. 405 (S.C.).

The court distinguished "common interest privilege" from "joint interest privilege". In the case of the latter, "each [client] must join in the waiver of privilege ... This is to be contrasted with common interest privilege, where it will not always be necessary for all the interested parties to concur in the waiving of the privilege in order for the privilege to be waived." (para. 23). Because of the conflict of interest that arose, a common interest no longer existed and each party was free to use the material in question.

Tara McPhail and Andrew Wilkinson of McCarthy Tétrault LLP provide the following summary of a US ruling in *Teleglobe USA Inc. v. BCE Inc.* on this issue that provides clarification of the law and guidelines for in-house counsel:

On July 17, 2007, the United States Court of Appeals for the Third Circuit (Court of Appeals) handed down a critically important ruling for in-house counsel regarding solicitor-client privilege (). They note that the decision, *Teleglobe USA Inc. v. BCE Inc. (In re Teleglobe Communications Corp.*), F.3d (3d Cir. 2007), clarifies the often-confused forms of solicitor-client privilege and provides in-house counsel with guidance on how to structure their companies' affairs to preserve privilege, particularly when transactions cross the Canada-US border.

When BCE purchased Teleglobe in 2000, BCE pledged financial support to Teleglobe to create a global data network. When the technology bubble burst, BCE ceased funding Teleglobe. Teleglobe, along with several of its American subsidiaries, filed for bankruptcy protection. Teleglobe's creditors sued BCE.

During the ensuing litigation, Teleglobe's creditors asked to see all documents that had been produced for or by BCE relating to the decision to discontinue funding Teleglobe, including opinions of outside counsel. BCE opposed that request.

In its decision of July 17, 2007, however, the Court of Appeals made several rulings that should ease the minds of in-house counsel. The Court of Appeals remanded the case back to the District Court – on the grounds that the District Court had not made a factual finding that would allow it to set aside BCE's privilege. Ultimately, the Court of Appeals clarified the law of solicitor-client privilege as it applies to the modern corporate office, and provided in-house counsel with clear guidance on conducting their companies' affairs in order to protect privilege.

The Court of Appeals found that the District Court had misconstrued the type of solicitor-client privilege at issue when the District Court found that the communications between BCE and Teleglobe regarding the discontinuation of Teleglobe's funding were subject to community-of-interest privilege.

The Court of Appeals held that community-of-interest privilege applies only where several parties are represented by *different* lawyers on matters of common interest to the parties. It further held that co-client – or joint client – privilege applies if the *same* lawyer is representing both a parent and subsidiary company on matters of common interest, as is typically the case in a

modern corporate office. This means communications among parties to the joint representation are protected from compelled disclosure to parties outside the joint representation.

The Court of Appeals held that if BCE and Teleglobe had been jointly represented on matters of common interest, then the communications made during the course of the joint representation were discoverable. The Court of Appeals expressly rejected BCE's position that the discoverability rule should not apply when the parties are related entities (i.e., a parent and subsidiary company). Further, the Court of Appeals held that the communications arising from the joint representation between BCE and Teleglobe remained discoverable in litigation even after their interests became adverse.

On remanding the case back to the District Court, the Court of Appeals held that it is up to the District Court to determine whether BCE and Teleglobe were jointly represented regarding the discontinuation of Teleglobe's funding. Depending upon the true extent of the joint representation by in-house counsel, the District Court's earlier ruling compelling BCE to produce all communications regarding the discontinuation of Teleglobe's funding, including those documents produced by outside counsel for BCE's exclusive benefit, may or may not stand.

The Court of Appeals provided clear and readable guidelines to assist in-house counsel in structuring their companies' affairs to avoid the type of order issued by the District Court and upheld by Judge Robinson. These include (i) avoid joint representations except when necessary; (ii) limit the scale of joint representations; and (iii) use separate counsel when the interests of the parent and subsidiary company diverge.

The Court of Appeals also specifically advised against the use of joint representations in spin-off transactions as the parent company could risk giving up its privilege to a former subsidiary should litigation subsequently occur. Recognizing that spin-off transactions may take months and/or years to complete, the Court of Appeals suggested that the parent company retain outside counsel for the subsidiary company for spin-off transactions, while continuing to use joint representations on matters of mutual interest.

Tips for In-House Counsel

- Consider devising a strategy to determine when the interests of the parent and subsidiary companies should be jointly represented, and when the interests of the companies require separate representation.

- Document the strictly limited nature of any such joint representation, thereby limiting any future unanticipated loss of privilege over key opinions.

- Consider retaining outside counsel to represent the interests of subsidiary companies if the interests of the parent company and subsidiary company diverge.

- Consider whether to retain outside counsel for the parent company for any matters for which the parent company would not want to turn over documents to a former subsidiary company.

6.9 Types of Privileged Communications

- In general, all communications between a lawyer and client are encompassed by the privilege whether or not litigation is contemplated. Initial communications between a solicitor and client are privileged even though the client might subsequently decide not to retain the lawyer. This would encompass both oral and documentary communications passing between the lawyer and client whether from the client to the lawyer or from the lawyer to the client.

  Descoteaux v. Mierzwinski (1983), 44 N.R. 462; *Maranda v. Richer* [2003] S.C.S. No. 67 (S.C.C.)

- Communications from a third party, including documents brought into existence by the third party on the instructions of the client or the lawyer, are privileged. This would extend to a request by a lawyer to an accountant to prepare certain documents for the client.

- Communications by an agent of the lawyer to the client or by an agent of the client to the lawyer are privileged just as if the communications had been directly between lawyer and client. This is discussed below.

  Susan Hosiery Ltd. v. MNR 69 D.T.C. 5278 (Ex. Ct.); *Southern Railway of British Columbia v. Deputy Minister of National Revenue* 91 D.T.C. 5081 (B.C.S.C.); *IPSCO* 95 D.T.C. 5642 (F.C.T.D.)

- Communications between in-house counsel and employer are privileged.

  Crown Zellerbach Canada Ltd. v. Dep. A-G (Canada) 82 D.T.C. 6116 (B.C.S.C.); *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)* (1997), 32 O.R. (2d) 575 (Ont. C.T.); *Copthorne Holdings Ltd.* (August 3, 2005 (T.C.C.))

- Communications encompassed by the privilege usually include oral communications, correspondence, memos of solicitors, draft agreements and checklists.

  The Mutual Life Assurance Company of Canada 84 D.T.C. 6514 (F.C.T.D.)

- A Lawyer's accounts are also privileged. Correspondence from a client relating to an account, internal communication between a lawyer and his staff accountants and vouchers not forwarded to accounting have been held not to be "accounting records of a lawyer" and therefore may be subject to a privilege claim.

  Southern Railway, Zein (above); *Cimolai* 2005 D.T.C. 286 (T.C.C.); *Maranda v. Richer* [2003] S.C.J. No. 67 (S.C.C.); *Ministry of Attorney General v. Information and Privacy Commissioner* (June 18, 2007 – Ontario Superior Court of Justice, Divisional Court)

- The collection of relevant copy documents for a lawyer's brief for purposes of advising or conducting litigation with the dominant purpose of conducting litigation may become the subject of a privilege claim even though the uncollected originals were not privileged documents.

  Wough v. British Railways Board (1979), 3 W.L.R. 150 (H.L.); *Hodgkinson v. Simms*, [1989] 3 W.W.R. 132 (B.C.C.A.).

6.10 Non-Privileged Communications

If communications do not meet the criteria described above with respect to the solicitor-client privilege they will not be privileged. The following documents, for example, are likely not privileged *vis-à-vis* Canada Revenue Agency:

- unmarked copies of published financial statements;
- copies of executed agreements and documents briefs;
- correspondence between opposing lawyers;
- facts observed by a party in the course of solicitor-client relationships;
- audit inquiries (See *Biomedical Information Corp. v. Pearce* (1985), 49 O.R. (2d) 92 (Ont. S.C.));
- any communications between a lawyer and the client in a non-professional capacity. Casual communications between a lawyer and an individual will not be protected;
- communications with a lawyer acting as a business advisor in his capacity rather than as a lawyer. Consequently care must be taken in respect to memoranda delivered by in-house counsel who also serves as financial officer within a corporation;
- "Accounting Records of a Lawyer". Subsection 232(1) of the *Act* contains a definition of "solicitor-client privilege". These statutory provisions narrow the common law concept of privilege and exclude "the accounting records of a lawyer". There formerly was great debate about the meaning of this phrase and its application to a lawyer's trust accounting records. The seemingly conflicting case law was neatly summarized in a decision of the Alberta Queen's Bench in *Organic Research v MNR* [1991] 1 C.T.C. 417. Accounting records, however, have been held to include duplicate cheque requisitions, invoices for disbursements and photocopies of cheques sent by clients to pay accounts (see *Burnett* 98 D.T.C. 6658 (F.C.T.D.));

- an Environmental Audit Report was held not to be privileged even though it was used as a basis for a legal opinion and was commissioned by the lawyer (see *John Gregory v. MNR* 92 D.T.C. 6518 (F.C.T.D.));

- corporate records and minute books (*1013808 Ontario Inc. v. The Queen* 94 D.T.C. 6352 (Ont. Gen. Div.)).

6.11 How Is Solicitor-Client Privilege Claimed?

Section 232 of the *Act* contains a procedural code for solicitor-privilege claims. Some provinces such as British Columbia also permit an originating application to be made by way of petition with supporting affidavits to determine a question of solicitor-client privilege. See the discussion above in section 5.2 whether section 232 adequately protects a client's privilege.

The *Act* provides that when an officer of Canada Revenue Agency is about to seize documents in the possession of a lawyer pursuant to a search warrant and a solicitor-client privilege claim is made on behalf of a named client, then the documents shall be seized and packaged and sealed without inspection and placed in the custody of the Sheriff or such other custodian as may be agreed upon. The lawyer may retain the documents if the Canada Revenue Agency officer wishes to examine them or will require production of them pursuant to a requirement. In that case the documents may be packaged, sealed and identified with all pages initialled and numbered. Where the documents are held by a custodian, a lawyer may bring an *ex parte* application for an order authorizing the lawyer to copy the documents. No document in the lawyer's possession may be inspected, examined or seized without providing a reasonable opportunity to the lawyer to make a claim of solicitor-client privilege.

Strict time limits must be observed in solicitor-client privilege applications. The *Act* provides a period of 14 days within which the client, or the lawyer on behalf of the client, may apply for an order setting a date on which to determine the issue of privilege regarding the secured documents placed in custody. In setting this 14 day date, one must be careful to observe the notice requirements set out within the relevant Court rules. The order sought shall specify a date, not more than 21 days from the date of the order, for determination of the question whether the client has a solicitor-client privilege in respect of the documents and shall require production of the documents in question at that time. This order must be served within 6 days on the Deputy Attorney General of Canada and any custodian of the documents.

The determination of the issue of privilege in respect of the documents must be made in camera with the Judge having the right to inspect the documents. The Judge will then decide summarily the issue of privilege and will deliver concise reasons for a decision but must not disclose any details regarding the nature of the documents. A successful application will result in the return of the documents to the lawyer. Otherwise they are to be delivered to the relevant Canada Revenue Agency person for inspection in satisfaction of the investigatory powers employed. A failure to make the application to have the privilege claim heard within the requisite period will result in the delivery of documents to Canada Revenue Agency. This is often the result of the claim by a lawyer for privilege and the failure by the client to provide instructions for one of a number of reasons.

6.12 Accountants And Privilege

6.12.1 The Common Law

Canadian Courts have not recognized a privilege similar to solicitor-client privilege in respect of communications between clients and their accountants even though, in some circumstances, their roles are analogous. This was confirmed by the Federal Court of Appeal in *Baron v. The Queen* 91 D.T.C. 5055. The Court agreed with the views of the trial Judge that:

> "It is not at all strange that solicitor-client communications are privileged insofar as compellable evidence before the Courts concerned while those between an accountant and client are not. The purpose of the solicitor-client privilege is to ensure free and uninhibited communications between a solicitor and his client so that the rendering of effective legal assistance can be given. This privilege preserves the basic right of individuals to prosecute actions and to prepare defences. ... I do not think there is an overriding policy consideration of this nature in the case of an accountant-client communication. An accountant may, as a matter of professional ethics, be required to keep communications and other information concerning his or her client confidential. But this is not founded upon the need to ensure an effective system of the administration of justice."

This was also recently confirmed by the Federal Court of Appeal in *Tower* 2003 D.T.C. 5540. The Court rejected both "class privilege" for accountants and a "case by case" privilege claim.

Financial statements and accountants' working papers have not been considered the proper subject of privilege claims in the United States. These conclusions were reached on the basis that an auditor owes a duty to the public and not necessarily just to his client and that unfairness would result if working papers, which are compellable in litigation proceedings between private litigants, were exempt from disclosure in litigation involving a public authority such as government.

6.12.2 The "Agent" Doctrine - *Susan Hosiery* and *Southern Railway* Decisions

There are circumstances, however, where the communications involving accountants do have some protection and are not compellable. This principle was determined by the British Columbia Supreme Court in *Southern Railway v. The Queen* 91 D.T.C. 5081 which adopted the decision and reasoning of the Exchequer Court in *Susan Hosiery Ltd. v. The Queen* 69 D.T.C. 5278. In the latter decision the Exchequer Court stated:

> "Where an accountant is used as a representative or one of a group of representatives for the purpose of placing a factual situation or problem before a lawyer to obtain legal advice or legal assistance the fact that he is an accountant or that he uses his knowledge and skill as an accountant in carrying out such a task does not make the

> communications that he makes or participates in making as such a representative any less the communications from the principal, who is the client, to the lawyer; and similarly, communications received by such a representative from a lawyer whose advice has been so sought are nonetheless communications from the lawyer to the client."

More recently, see *Methanex Corporation et al. v. The Queen* [1997] 1 W.W.R. 573 (Alta. Q.B.).

The *Southern Railway* decision further confirms that documents located at the accountant's office may become the proper subject of a privilege claim that may and should be exercised by the client before the audit at that office commences.

In *Cineplex*, discussed above, the court described the rule as follows (94 D.T.C. 6408):

> "The general principle of law is clear that information or advice given in confidence between accountant and client is not the subject of privilege. The only exception is where information is given to or by the accountant as agent for the client for the purpose of obtaining legal advice for the client. Such information is then the subject of solicitor-client privilege by virtue of the agency. The principle is clearly stated by Jackett, P. of the Exchequer Court of Canada in *Susan Hosiery Ltd. v. MNR* (1969), 69 D.T.C. 5278..."

Then again at page 6409:

> "If the tax team provided advice to the client or to its solicitor that advice would not be privileged. It is only in the very limited situation where the tax team provides information to the solicitor for the purpose of the client's receiving legal advice that the privilege can be maintained. This is not the creation of an accountant-client privilege but the acknowledgement of an extension of solicitor-client privilege through the principles of agency."

This rule has been considered unnecessary in Australia. See *Pratt Holdings* (2004 A.T.C. 4526) in which the Australian Federal Court focused on the function that the advice served: Was the knowledge, skill and expertise truly required in order to instruct the legal advisors fully?

6.12.3 Audit Working Paper Requests

See the discussion at section 1.10 above.

6.13 Precautions to Maintain Privilege

In Canadian Tax Highlights, Jack Bernstein and Barbara Worndl of Aird & Berlis advised of the following precautions to maintain privilege for documents required for tax matters:

1. "Generally, do not retain draft documents (such as memoranda, agreements, tax-planning documents, associated notes, and correspondence) that are not required for the determination of taxes. For example, estimated values and allocations of purchase price may change from the initial draft agreement to the final agreement, and those initial documents may be - extraneous.

2. All communications between a lawyer and client that may be of a sensitive nature should be marked "privileged and confidential."

3. Ensure that privileged documents are not given to third parties.

4. If third parties such as accountants or actuaries are to be retained in connection with tax matters to provide tax or other advice, they should be retained by the lawyer.

5. Avoid inadvertent waiver of privilege. Ideally, all privileged documents should be maintained in a separate file.

6. Avoid detailing controversial issues on work in progress; if the client requests a WIP memo, be sure to provide it in a separate memorandum that is marked "privileged."

7. The number of privileged documents should be kept to a minimum in order to avoid inadvertent disclosure.

8. Avoid putting privileged or sensitive documents in minute books, which are included in the type of books that the CRA has the right to review.

9. Be careful when providing advice in e-mails and in controlling the direct (and indirect) recipients thereof. Provide sensitive advice over the phone or in person.

10. When an auditor requests privileged documents such as a legal opinion for the purpose of an audit opinion, the auditor and the client should agree in writing that the information is being released pursuant to a statutory obligation. The agreement should acknowledge that the - documents are subject to solicitor-client privilege that the client wishes to maintain and has not waived. The auditor should agree in writing that it is not permitted to disclose such information to third parties without the client's written consent. Once the audit is completed, the documentation should be returned to the client or verified to have been destroyed."

7. <u>Disclosure of Information to be Used in a Criminal Proceeding</u>

Canadian courts have now limited the use of information derived by Investigations in a criminal investigation even though the *Act* is a regulatory statute. In 2002 the Supreme Court of Canada determined in the *Ling* 2002 D.T.C. 7566 and *Jarvis* 2002 D.T.C. 7547 decisions that only a search warrant can be used to obtain information for special investigations and not the powers in section 231.1 and 231.2 of the Act. Further, the court confirmed the Charter right to remain silent and not to incriminate oneself. However, the commencement of a criminal investigation must be identified because the Charter's procedural protection is only engaged at that time. Ordinary regulatory or audit powers may be exercised without procedural safeguards. Yet they

cannot be used to further a criminal investigation. See for example, *Les Plastiques Algar* 2004 D.T.C. 6296 (F.C.A.), *Dwyer* 2003 D.T.C. 5575 (F.C.A.), *Kligman* 2003 D.T.C. 5100 (F.C.T.D.), *Stanfield* 2005 D.T.C. 5454 (F.C.) and *Borg* 2007 ONCJ 451. See above at section 5.3. Information, however, may be handed over by auditors to Investigators for a subsequent criminal investigation. See also *The Queen v. Norway Insulation* 95 D.T.C. 5328 (Ont. Gen. Div.), *O'Neill Motors* 98 D.T.C. 6424 (F.C.A.), *Warawa* 2005 D.T.C. 5093 (F.C.A.) and *Redeemer Foundation* 2005 D.T.C. 5617 (F.C.) regarding the ability to set aside reassessments because they are based entirely on evidence that cannot be admitted in Tax Court because of Charter breaches.

8. What Should You Do When Canada Revenue Agency Arrives?

The following are some guidelines that one might observe before, if and when Canada Revenue Agency arrives to exercise investigatory powers:

8.1 General Pointers

- Don't panic. Phone your lawyer immediately or as soon as possible. You may wish your lawyer to go to your premises if possible. Ask Canada Revenue Agency Officials to wait until you have had an opportunity to consult your legal counsel about such issues as the need for a search warrant and the issue of privilege.

- Do not permit the Canada Revenue Agency Official to enter the premises if you are in a "dwelling house" and the Canada Revenue Agency Official does not produce a warrant authorizing entry.

- If the Canada Revenue Agency Official does present a search warrant, ask him for the opportunity to call your lawyer so he can examine it and determine its contents before permitting him to enter.

- Require the Canada Revenue Agency Official to produce his authorization card. If possible, xerox his authorization card to determine his authority to act in the circumstances. Criminal investigators are required to wear identification badges.

- Determine the nature and reasons for his investigation, call or visit (if it is a seizure or a requirement to provide documents, see below). Also determine whether this interruption is going to occur at a "reasonable time". If not, arrange for the investigator to contact you at a more suitable time.

- In all situations you should:

    - obtain the names of all Canada Revenue Agency Officials;

    - keep careful and detailed notes of all conversations;

    - have at least two persons present at all times;

- not obstruct the investigator;
- give "reasonable assistance" and answer all "proper questions".

Remember it is an offence to hinder, molest or interfere with Canada Revenue Agency Officials, subject to claims for privilege.

8.2 Routine Audit

Ask the following questions if no search warrant is produced or required, or if a requirement for provision of documents or information is not served personally:

- What is the purpose related to the administration or enforcement of the *Act* that has prompted the investigation, call or visit by Canada Revenue Agency?
- Is the Canada Revenue Agency Officer intending to inspect, audit or examine any document that relates or may relate to information that is or should be in the books or records or to any amount payable by the person under investigation?
- What books and records or documents does the Canada Revenue Agency Official specifically wish to see? Ask the Canada Revenue Agency Official to be clear and specific about which documents he specifically is intent on receiving.
- Is the Canada Revenue Agency Official intending to examine property in an inventory or any property or process or matter relating to the person under investigation? If so, ask the Canada Revenue Agency Official what purpose he believes this examination will serve? You should know that the examination is only appropriate for purposes of determining the accuracy of the inventory of the person under investigation or in ascertaining information that is or should be in the books or records of the person under investigation or any amount payable by the person under investigation under the *Act*.

8.3 Requirements To Provide Documents or Information

- Ask the Canada Revenue Agency Official whether he is personally serving a written requirement to provide documents or information.
- If so, you should realize that you have a "reasonable time" within which to respond.
- Ask him to give you the opportunity to consult with your lawyer before accepting the letter and do not answer any questions or give over documents in a panic.
- Try to ask the following questions:
    - What is the purpose related to the administration and enforcement of the Act prompting the service of the requirement to provide documents or information?

- What is the name of the person about whom the information is sought and what are the reasons why the information or documents are being sought?

- If he does not name the persons about whom he is seeking information or documentation, ask him: "Please provide me with an authorization granted by a Judge permitting you to obtain this information or documentation."

- Notify any person named by the Canada Revenue Agency Official and advise him to notify his lawyer.

8.4 Search Warrants: What a Client Should Do In The Event of a Search Pursuant To a Search Warrant At The Client's Office

- Contact its lawyer immediately.

- Ask the investigating officers to produce the document purporting to give authority to search and the information sworn in support of the warrant. Criminal investigators must wear identification badges.

- Record the names of the investigating officers.

- Take notes of all conversations including the times of the conversations.

- Have at least two persons present at all times.

- Enquire if the investigation involves the party being searched or another party.

- Neither assist nor obstruct the investigation.

The client may claim solicitor/client privilege with respect to documents in its possession as follows:

- Determine whether or not any of the documents are privileged. If in doubt, consider them privileged.

- Claim privilege for the whole of the file that contains privileged documents. Ask the officers to seal and deliver the documents or file to the nearest Supreme Court registry until the determination of the question of privilege can be made by a Supreme Court Judge.

- If the investigators refuse to do this, ask permission to go through the file in order to pull out privileged documents that will be sealed and delivered to the Supreme Court.

- If this procedure is refused, try to have the documents sealed before the investigators take them and try to get photocopies of all documents taken before the officers leave.

8.5 What To Do In The Event Of A Search Of A Law Office Or Accounting Firm

- Consider the need for legal counsel.

- Get a copy of the search warrant and the information sworn in support of the application for the warrant (if possible) and check it to determine that it is correct on its face. Note any limitations to the authority granted.

- Determine if the investigation is of the firm, a client or another party.

- If the search is with respect to a client, call the client immediately to advise the client with respect to the search and to determine whether or not the client wishes to cooperate with the search.

- Have at least two persons from the office present at all times.

- Unless authorized to cooperate by the client neither assist nor obstruct the investigation.

- Keep very detailed notes including times of all conversations and notes of any documents seized by the investigators, as well as names of all investigating officers.

- Consider and if possible (as a client or lawyer) claim privilege for each privileged document which is sought to be inspected or seized. In a search by Canada Revenue Agency, a lawyer should (but need not) claim privilege for a named client of the firm in respect of each privileged document which is sought to be inspected or seized.

- Pursuant to Section 488.1 of the *Criminal Code* or Section 232 of the *Act* ask, if a lawyer, that the documents be sealed and placed in custody.

- As the client or lawyer, you have 12 days (14 days less a two-day notice to all other persons entitled to make application - *Criminal Code*) or 11 days (14 days less a three-day notice requirement to the Deputy Attorney General under the *Act*) to:

    - make an application pursuant to subsection 488.1(3) of the *Criminal Code* or subsection 232(4) of the *Act* asking the Court to make a determination of the question as to whether the documents should be disclosed.

    - peruse the documents (under subsection 488.1(9) on *ex parte* application or under subsection 232(13) on *ex parte* application) with a view to being

more selective as to which specific documents to claim as privileged. Failure to follow this step will result in the turnover of the documents to the Canada Revenue Agency Official at the expiration of 14 days.

Further investigations to determine exactly what procedural steps must be followed and the related timing requirements may be necessary.

PART VII - DEALING WITH THE INTERNAL APPEALS DIVISION OF CANADA REVENUE AGENCY

1. Overview

Once the reassessment has been issued, the taxpayer must file a Notice of Objection to continue disputing the reassessment with Canada Revenue Agency. In December 2006, the Canada Revenue Agency indicated that it received about 50,000-70,000 objections annually relating to income tax, GST/HST, excise tax, CPP and EI. About 92% are received administratively; of the 8% (4000-5600) appealed to court: 33⅓% are withdrawn, 33⅓% are settled and 33⅓% are heard by a judge. In 2006-2007, there were 53,741 objections. 90% related to T1's, 1% (388) to large corporation T2's; and 5% (2,728) related to small and medium sized corporations. 4% related to tax avoidance and other matters.

The issues and procedures relating to the Notice of Objection are discussed below. Once the objection is received by Canada Revenue Agency, the taxpayer's file is then physically moved from audit to the Appeals Division. The following are the basic differences between dealing with audit and appeals:

- the precise adjustments to the taxpayer's return have now been identified and quantified in the reassessment and the attached T7W-C;

- Canada Revenue Agency is primarily conducting an independent review of the auditor's work although it is not uncommon for an appeals officer to obtain additional information.

A tax advisor should obtain the auditor's T20 report, T2020 working papers and any related documents before dealing with appeals. Even if the advisor had participated in the audit, obtaining these documents will assist in determining the precise basis upon which the auditor reassessed. An advisor must first and foremost try to learn the facts and issues relating to the appeal. If unable to obtain the auditor's T20 and related documents informally then the advisor should consider making an application under the *Access to Information Act* or the *Privacy Act* (discussed above).

The goal at the appeals level is to obtain a notice of reassessment cancelling the notice of assessment or reassessment issued by the auditor. Canada Revenue Agency will assign an appeals officer to the taxpayer's objection. The appeals officer conducts the initial review and ultimately reports to the Chief of Appeals. It is the Chief of Appeals who has the authority to issue a confirmation, or to vary or vacate a reassessment.

A meeting with the appeals officer is often useful. This will help to focus on the facts in issue and any differences on applicable law. It will also assist in determining whether there are any differences of opinion on facts and law between the auditor and the appeals officer. Ascertain whether the appeals officer has properly reviewed earlier submissions and information provided by the taxpayer and what additional information or submissions will be useful and persuasive to the appeals officer.

The tax professional should also be assessing the evidence to support the taxpayer's position. In other words, the advisor must consider how to prove every relevant fact in a court of law. It may well be that the entire case rests on *viva voce* evidence and accordingly no documentation supports the taxpayer's position. Where *viva voce* evidence will be crucial in a trial of the issues, ask the appeals officer to seek advice from the Department of Justice. The appeals officer may be already discussing the case with a lawyer from the Department of Justice. It is important to establish this framework for analysis and present it to the appeals officer as appeals officers have assumed much more responsibility for the preparation of files for an appeal than they formerly did. In particular, files which will proceed under the informal procedure in the Tax Court are often prepared by the appeals officer. Any particular appeals officer may have participated in one or more examinations for discovery and is thus attuned to the need for evidence at a trial. This focus on evidentiary issues is typically to the taxpayer's advantage as it exposes the weaknesses in the assumptions made by the auditor in preparing the reassessment.

Nevertheless, appeals officers still tend to have a "black letter view of the law". Appeals officers will still rely quite heavily on the following Canada Revenue Agency publications for determining what the "law" is:

- Interpretation Bulletins;
- Information Circulars;
- Advanced Tax Rulings;
- Technical Interpretations;
- Tax Technical News;
- Tax Operation Manuals;
- Transfer Pricing Memoranda.

It is not uncommon for the appeals officer to attempt to justify the assessment on a basis different than that of the auditor. While this will frustrate the advisor and the taxpayer, it may give an advantage if the matter is litigated because the burden of proof may shift to Canada Revenue Agency. With respect to the independent review by audit, Canada Revenue Agency is entitled to make additional assumptions of fact to justify the assessment. For example, in *Bowens v. MNR* 94 D.T.C. 1853 (T.C.C.), the appeals division made assumptions of fact that were contrary to the assumptions of fact made by the audit division. The assumptions of fact made by the audit division were not pleaded at trial. The taxpayer introduced the assumptions of

fact to rebut the assumptions pleaded. The Tax Court agreed that the taxpayer could rely on these unpleaded assumptions to rebut the pleaded assumptions.

It is also in appeals that the Fairness Package is used to obtain a settlement. Typically, a taxpayer will accept a reduction of the amount payable in exchange for certainty. The Fairness Package might be used to reduce the interest and/or penalties associated with the assessment. However, Canada Revenue Agency has indicated that it will not settle cases using the Fairness Package without justification based on the guidelines published in the Information Circulars.

2. Deadlines for Filing the Notice of Objection

(a) Generally

The taxpayer generally has 90 days from the date of mailing of the notice of assessment within which to file a Notice of Objection. The onus is on the taxpayer to prove that the objection notice was sent (*Jones* 2004 D.T.C. 6185 (F.C.), *870 Holdings* 2004 D.T.C. 6001 (F.C.A.)). The time limit is set out in subsection 165(1) of the *Act*. Even if discussions with Canada Revenue Agency are continuing, it is prudent to file a notice of objection to protect the taxpayer's rights to continue to dispute the reassessment.

(b) Longer Period For Individuals and Testamentary Trusts After Assessment

For certain taxpayers, the period for filing may be extended in certain circumstances. (Taxpayers who are individuals or testamentary trusts.) The deadline for filing a notice of objection may be extended to the "the day that is one year after the balance due date of the taxpayer for the year". The balance due date is defined in subsection 248(1) to coincide with the taxpayer's due date for filing a return for the year. However, under subsection 165(2.1), this extension only applies to assessments, determinations and redetermination under subsections 152(1), (1.1) and (1.2). The taxpayer must file a separate notice of objection for each notice of assessment or reassessment, particularly because a notice usually has the effect of cancelling another. This will also arise where Canada Revenue Agency has reassessed more than one taxation year. Canada Revenue Agency will issue one notice of assessment for each taxation year and accordingly one notice of objection for each taxation year must be filed.

(c) Nil Assessment

No objection can be filed to a "nil assessment". Most recently, the TCC decided this in *On-line Finance & Leasing Corporation* 2009 T.C.C. 565. See also section 3.7 of this paper. A lengthy discussion of the Federal Court of Appeal is contained in *Interior Credit Union* 2007 FCA 151. The decision affirms that tax balances cannot be appealed unless the Act otherwise contemplates this.

An objection can be filed if there is interest or a penalty assessed even if no tax is owing. The CRA has an administrative practice of considering the issues in an objection to a "nil assessment with a view to resolving them when they are current in the minds of the objector and the CRA auditor".

3. Form of the Notice of Objection

The *Act* no longer prescribes a form for the filing of a notice of objection. Accordingly, Canada Revenue Agency will accept a notice of objection as long as it is in writing as required by subsection 165(1). It is prudent to continue to use Form T400A because it is recommended by Canada Revenue Agency. In administering the former rules as to the form of the Notice of Objection, Canada Revenue Agency required the taxpayer or a responsible representative of a corporate taxpayer to sign the Notice of Objection. Although the *Act* is silent on this point, it is prudent to have the taxpayer execute the notice of objection and to authorize the advisor to speak to the appeals officer on behalf of the taxpayer.

Subsection 165(1) states that a Notice of Objection must set out the following:

(a) reasons for the objection; and

(b) all relevant facts.

Subject to the discussion of the rules applicable to large corporations below, the taxpayer is not estopped from raising new issues at the appeals level and later at the Tax Court. However, the Notice of Objection does form part of the taxpayer's file and subsequently the Court record. It is therefore important to set out the germane facts and sections of the *Act* upon which the taxpayer relies.

There are a number of details in a Notice of Objection that Canada Revenue Agency likes to see. The first of these is the taxpayer's account number. This may be the social insurance number for individuals or the corporate account number for corporate taxpayers. The notice of assessment or reassessment number should be included along with the taxation year and a copy of the relevant notice. Second, Canada Revenue Agency asks taxpayers to indicate whether they are asking for a review of information already given or if they are providing new information.

4. Service

Service of a notice of objection is accomplished by delivering or mailing the notice to the district office or taxation centre of Canada Revenue Agency for the taxpayer. It is no longer necessary to send the notice of objection by registered mail. The envelope and the notice of objection should be addressed to the "Chief of Appeals" at that office or centre. As a practical matter, taxpayers will no longer be required to obtain registration receipts (e.g. double registered mail) for their records. However, one should ask Canada Revenue Agency to confirm in writing the receipt of the notice of objection. There is no equivalent provision to paragraph 248(7)(a) of the *Act* upon which the taxpayer can rely. In other words, the taxpayer cannot merely say "I mailed the notice" and thus have it considered to be served. Subsection 165(6) provides that the Minister may accept a notice of objection notwithstanding that it was not served in the manner required by subsection 165(2).

5. Duty of the Minister

Subsection 165(3) says that the Minister shall, with all due dispatch, reconsider the assessment and vacate, confirm or vary the assessment or reassess. Notification in writing is then to occur. The Minister may then issue a Notice of Assessment or Notification of Confirmation.

Appeals are not to be allowed just because due dispatch is not exercised. See *Bolton* 96 D.T.C. 6413 (FCA), *James* 2001 D.T.C. 5075 (FCA) and *Santerre* 2005 TCC 606.

6. Process Within the Canada Revenue Agency

On November 6, 2007, the CRA described the Appeals Intake System at a Joint Discussion Group Meeting of the CBA and CRA (Pacific Region):

> **Question 6: Appeals Intake System**
>
> Please describe the Appeals intake system, including the factors taken into account in assigning Objections.
>
> a. Does/will CRA consider the location of the Taxpayer/representative?
>
> b. There are situations where meetings with the Appeals Officer may be important to the potential resolution of an Objection. If the Taxpayer was prepared to wait for an Appeals Officer locally, does/would CRA consider this factor in assigning Objections?
>
> **CRA Response**
>
> There are two national intake centres responsible for front-end processing of Appeals workflow. The Eastern Intake Centre is located in the Sudbury Tax Services Office and the Western Intake Centre is located in the Burnaby-Fraser Tax Services Office. The Western Intake Centre handles the workload for the offices in the Prairie and Pacific Regions.
>
> Some of the duties of the Intake Centre are:
> - records objections received on our mainframe systems.
> - determines if objections are valid or invalid.
> - obtains working papers to make the file ready to work by any Appeals Officer.
> - allocates files based on various factors.
> - sends acknowledgement letters to taxpayers and/or their representatives.

Some of the factors taken into account in allocating files are as follows:

- Complex files such as Tax Avoidance, Large Case, Enforcement and International Audit are assigned to the office where the audit was undertaken.
- Small and medium business files are allocated based on capacity in the Appeals offices to ensure objections are resolved in a timely manner.

a. It is a continuing goal of the Canada Revenue Agency (CRA) to provide accurate and efficient service of the highest quality. One way of attaining this goal is to constantly review CRA processes and procedures to ensure it provides cost-effective service to Canadian taxpayers by making the best use of staff. It is therefore necessary for the CRA to have the flexibility to have objections reviewed where the capacity exists, which means that an objection may be reviewed by a tax services office or a tax centre further away from the taxpayer's residence. Nevertheless, the CRA recognizes that there are advantages to both the Agency and the taxpayer in having face-to-face meetings when necessary to resolve more complex issues. Our objective is to strike a balance between ensuring that required meetings do take place and delivering service in the most cost-effective manner.

   The issue of face-to-face meetings is currently being examined from which improved criteria may be developed to identify objections that require face-to-face meetings. To that end the CRA would welcome your input on this issue so that the CRA can develop policies and procedures that indeed strike the balance between required face-to-face meetings and cost-effective service delivery.

b. Most of our files are resolved without the need for a meeting. We do recognize that at times face-to-face meetings are required to work through complex issues to resolve a file and, when this occurs flexibility exists to:
   - Move a file to another office or
   - Have the officer travel to a meeting.

   While there are very good reasons for a face-to-face meeting, we wish to reduce meetings where self-explanatory information is handed over to the Appeals Officer. When this happens, the redress process becomes more expensive and less effective.

7. Large Corporations Objections (Subsections 165(1.11) to (1.14))

7.1 Background

Draft legislation relating to objections and appeals of federal income tax by "large corporations" was released on September 26, 1994 (and ultimately passed in 1995). The legislation found in subsections 165(1.11) and 169(2.1) of the *Act* may well have been prompted by the 1992 decision in *Gulf Canada Limited.* After that decision, many taxpayers revised their notices of objection to include the reasons contained in that decision. As a result, Canada Revenue Agency settled many outstanding objections in favour of the taxpayer that were not otherwise budgeted for by the Federal Government. This resulted in an unexpected loss of revenue transfer. The Department of Finance concluded the Crown could not adequately project revenues without curtailing large corporations' rights to change the basis upon which they object to a reassessment.

These rules represented a dramatic shift in manner in which a notice of objection might adequately be drafted. The Courts had previously held that a taxpayer could raise new issues not raised in the notice of objection (*Midwest Oil Productions Ltd. v. The Queen* 82 D.T.C. 6092 (F.C.T.D.) affirmed 83 D.T.C. 5304 (F.C.A.)). This notion was based on the premise that an assessment or reassessment results in an amount payable by the taxpayer and is not necessarily issues oriented.

7.2 What is a "Large Corporation"?

For the purpose of the legislation, a corporation is defined to be a "large corporation" within the meaning of subsection 225.1(8). That subsection includes not only corporations that are subject to the Large Corporations Tax ("LCT") contained in Part I.3 of the *Act* but also corporations related to those subject to LCT.

7.3 Contents of the Notice of Objection

Under the rules relating to large corporations, a notice of objection must specify:

- material facts (paragraph 165(1.11)(c));
- each issue to be decided (paragraph 165(1.11)(a));
- reasons for objection (paragraph 165.(1.11)(c)); and
- the relief sought (subparagraph 165(1.11)(b)). It must be expressed as the amount of a change in any one of the components of the term "balance". That term is defined in subsection 152(4.4) as:
  - income
  - taxable income
  - taxable income earned in Canada

- any loss
- tax or any amount payable
- any amount refundable, or
- any amount deemed to have been paid or to have been paid as an overpayment.

As a result, the notice of objection for a large corporation will be valid only if it specifies at least one issue. Under subsection 165(1.13) of the Act, a large corporation may only object to an assessment if it complies with the rules.

In addition, the legislation requires the taxpayer to claim, in the alternative, the benefit of an elective deduction such as capital cost allowance. This ensures that Canada Revenue Agency is able to compute whether the Crown will be receiving any money in the event that it is successful regarding the issues raised in the notice of objection.

7.4 Late Compliance

If the notice of objection does not comply with the requirements of 165(1.11)(b) of the Act then Canada Revenue Agency may request that the large corporation provide this information. Under subsection 165(1.12) of the Act, the corporation will then have 60 days to provide the information. This provision does not mandate a request by Canada Revenue Agency and it does not restrict a taxpayer's right to submit the information on its own. In fact, the legislation is silent on the effects of an amended notice of objection. Obviously, a large corporation should comply at the time of filing. It should also be noted that the late compliance provision only relates to the remedy sought by the large corporation and not to the issues. Therefore it would appear that the Minister may not later request a reasonable description of each issue to be decided if it was omitted from the notice of objection.

7.5 Subsequent Reassessment

Under subsection 165(1.14) of the Act, a large corporation may object to an assessment on different grounds if the assessment relates to an issue not previously raised by Canada Revenue Agency. In other words, if, as a result of a notice of objection, Canada Revenue Agency reassesses on different grounds under subsection 165(3) of the Act, the large corporation may object to the new grounds.

7.6 Failure to Comply with the Legislation

The failure to comply will render the notice of objection invalid. Moreover, subsection 169(2.1) of the Act only permits a taxpayer to appeal to the Tax Court of Canada in respect of issues described in the notice of objection. The scope of the failure to comply has recently become the subject of judicial comment by the Federal Court of Appeal.

In *Potash Corporation of Saskatchewan, Inc.* (2003 D.T.C. 509 (T.C.C.), reversed 2004 D.T.C. 6002 (F.C.A.)), the taxpayer made claims for resource allowance and earned depletion for the

1993 through 1996 taxation years. Canada Revenue Agency issued reassessments to the taxpayer reflecting changes to the computation of resource profits resulting from the exclusion of certain items of income. Canada Revenue Agency attached a schedule to the notices of the reassessment summarizing the categories of income excluded from the computation of resource profits. Both resource allowance and earned depletion are determined on the basis of a formula that includes resource profits.

The taxpayer filed notices of objections for the 1993 through 1996 taxation years. In its notices of objection, the taxpayer briefly outlined the "statement of facts", the "reasons for the objection" and the "relief sought". In its statement of facts, the taxpayer only referred to certain types of income for purposes of the calculation of "resource profits" for the resource allowance under paragraph 20(1)(v.1) of the Act. The objection further stated that the reassessment by Canada Revenue Agency had reduced resource profits by the amount of certain miscellaneous items of income which resulted in a reduction of the deductions for the resource allowance and for earned depletion. Not all of the sources of income eliminated by Canada Revenue Agency through its notice of reassessment were the subject of objection. The overall deduction for resource allowance and earned depletion was the sole issue under objection.

The reassessments were confirmed by the Minister of National Revenue with respect to the computation of resource profits. The taxpayer then appealed to the Tax Court of Canada and the notices of appeal substantially repeated the allegations relating to the computation of resource profits that were in the notice of objection with the same particulars. During the course of fulfilling undertakings requested in examinations for discovery, the taxpayer discovered or "was reminded" that the computation of resource profits in its income tax returns as filed excluded five different amounts which the taxpayer proceeded to assert had been inadvertently excluded. Consequently, approximately three weeks before the hearing of its appeal before the Tax Court of Canada, the taxpayer filed a motion in the Tax Court of Canada to amend its notice of appeal on the basis that the notice did not raise any issues not already raised in the context of the other items, and that the Minister would not be prejudiced. The taxpayer alleged that the amendment was necessary to avoid a future claim by the Minister that the five new items were subject to a plea of *res judicata* or issue estoppel. The judge in the Tax Court of Canada permitted the taxpayer to amend its notice appeal, notwithstanding the objections by the Crown. Mr. Justice Beaubier determined, upon reviewing paragraph 169(2.1)(a) of the Act, that the taxpayer had sufficiently complied with subsection 165(1.11) by specifying in the notices of objection the issue to be decided, namely "resource profits deductions", by using the simple heading "resource allowance" and by stating the amounts in controversy as accurately as could be done at the time. He further concluded that the failure by the taxpayer to specify certain categories of the computation of resource profits, which meant that the total amount in controversy was somewhat greater than disclosed in the notice of objection, did not bar the taxpayer from having those additional items considered as part of its determination of the question of whether the resource profits had been correctly computed.

In a unanimous decision, the Federal Court of Appeal determined that the Crown's appeal should be allowed and that the order of the Tax Court should be set aside. Consequently the taxpayer's motion to amend its notice of appeal was dismissed. Mr. Justice Malone concluded that the proposed amendments to the notice of appeal sought to include in the computation of resource profits for the 1993 through 1996 taxation years five new items of income not described in the

notice of objection and as a consequence, sought to increase the amount of the resource allowance and earned depletion from the amount set out in the notices of objection. He and the other members of the Court concluded that this would permit the taxpayer to amend its pleadings contrary to the requirements of subsection 169(2.1) of the Act. Mr. Justice Malone recognized that this was a harsh result for the taxpayer and consequently that subsection 169(2.1) delivers a harsh rule for large corporations. In his words "that is the result that the Parliament intended". Therefore a large corporation that discovers an error in an income tax return after it has filed a notice of objection or notice of appeal may find itself barred from taking proceedings to compel the Minister to correct the error.

The decision is not all bad news for taxpayers. The Federal Court of Appeal provided a number of guidelines with respect to the application of this "harsh rule" within the body of its judgment. At paragraph 21, the Court stated:

> "The Large Corporation Rules place further requirements on large corporations that object to an assessment by the Minister. The main issue in this case is the meaning to be given to the words 'each issue' and the phrase 'reasonably describe each issue to be decided' in paragraph 165(1.1)(a)."

Mr. Justice Malone did not agree with the interpretation by Mr. Justice Beaubier of the Tax Court that the issue is the legal matter which the taxpayer contests with Canada Revenue Agency and is not required to be described exactly. Mr. Justice Malone further disagreed that the issue could be expressed in section numbers of the Act or in words taken from or paraphrased from those sections. In paragraph 22, he stated:

> "While a large corporation is not required to describe the issue 'exactly' as the Judge states, it is required to describe the issue 'reasonably'. What is reasonable will differ in each case and will depend on what degree of specificity is required to allow the Minister to know each issue to be decided."

The Court seemed to focus on the need for the taxpayer to give sufficient certainty to Canada Revenue Agency as to what issues are under objection. Mr. Justice Malone stated in paragraph 24:

> "It would not have been reasonable to simply say that the computation of 'resource allowance' or 'resource profits' was in issue, without specifying the particular elements of that computation that required a determination by the Minister or the Tax Court, as the case may be. That level of generality would render the Large Corporation Rules meaningless, defeating the purpose of their enactment."

If so, what could create a harsh result for a taxpayer is the apparent need to specify in great detail some of the computational issues that the taxpayer and the Crown disagree upon. Paragraph 27 of the decision provides some guidelines:

> "The Judge made a number of comments relating to the statutory requirement to specify an 'amount' for each issue. If he had determined, as he should have done, that PCS is not entitled to include the five disputed items in the notice of appeal, there would have been no need to discuss quantification at all. Nor is it necessary for me to comment on it. I prefer to leave open the question of whether the obligation to 'specify in respect of each issue the relief sought, expressed as the amount of a change and a balance (within the meaning assigned by subsection 152(4.4)) or a balance of undeducted outlays, expenses or other amounts of a corporation' necessarily binds a large corporation to the stated amount, or a less favourable amount. It is arguable that there may be situations where an amendment to a notice of appeal could be permitted if the amendment goes only to quantum and does not entail the raising of a new issue."

This language from the Federal Court of Appeal leaves open the possibility of amendment provided the Court is certain that the taxpayers have created a sufficient degree of specificity regarding the issue in dispute that creates certainty for the parties regarding the dispute itself. The Federal Court of Appeal acknowledged in paragraph 4 of its judgment why the Large Corporation Rules were enacted. In doing so, the Court quoted from a paper published by Bob Beith in 1994 regarding this legislation. To quote the Court, "simply put, Parliament wants the Minister of National Revenue (the "Minister") to be able to assess at the earliest possible date both the nature and quantum of pending tax litigation and its potential fiscal impact". The Court also referred to the fact that "it is essential that revenues be more predictable and therefore that potential liabilities be identified and resolved within a more reasonable time".

7.7 Conclusion

The premise of the legislation is that large corporations normally have the ability to specify the relief they are seeking. In the lead-up to a reassessment, the corporation's representatives and Canada Revenue Agency set out the dispute in writing. The notice of reassessment will set out the increase in tax and the T7WC indicates how the adjustments were computed. Any court decision which provides an additional argument for the taxpayer will be excluded from consideration.

Canada Revenue Agency has stated publicly that it is aware that there are circumstances where even a large corporation may not necessarily have the information to meet the requirements of the proposed legislation. In those circumstances Canada Revenue Agency will use the discretionary provision in the legislation and send the letter to the corporation specifying the deficiency and permitting the corporation to correct the deficiency.

Prior to the decision in *Potash Corporation* it was difficult to determine whether the "large corporation" legislation would prevent large corporations from raising additional issues decided by the Courts after the notice of objection had been filed. At the 1994 Annual Conference of the Canadian Tax Foundation, Bob Beith, Director-General of Appeals, indicated that Canada Revenue Agency would be flexible in the application of these rules. Given the definition by the

Federal Court of Appeal of the policy considerations underlying the enactment of the Large Corporation Rules in 1995, it will be interesting to see whether that flexibility will continue to be exercised. It is hoped that the government will clarify the extent to which it will attempt to apply the principles established by the Court in the *Potash Corporation* decision. Perhaps the Crown will determine that the findings in *Potash Corporation* should be limited to their facts: a taxpayer seeking to amend pleadings three weeks before trial after discoveries had completed.

In 2004, the CRA affirmed their desire to rely on *Potash Corporation* and the 1994 "Beith" guidelines (2004 Annual Conference of Canadian Tax Foundation) 5A:7. In 2010, the Tax Court did not apply the *Potash* decision to the detriment of the taxpayer. See *Heritage Education Funds* 2010 TCC 161.

8. Applications for Extensions of Time

Under amendments to the *Act* in 1991, applications for extensions of the time limits for serving notices of objection under section 165, or for making requests for GAAR adjustments in accordance with subsection 245(6), must be made to the Minister. Sections 166.1, 166.2 and 167 are applicable to applications for extensions of time filed after January 16, 1992. These new provisions relate only to an assessment of tax under the *Act*. They do not relate to assessments of liability under the *Canada Pension Plan* ("CPP"), the *Employment Insurance Act* ("EIA") or provincial income tax, although the liability for the latter is often dependent on liability under the *Act*. The *CPP* and the *EIA* must be reviewed in the context of a source deductions assessment.

8.1 How To Apply

Under subsection 166.1(1), a taxpayer must apply to the Minister for an extension of the time limit to serve a notice of objection or a request for a GAAR adjustment. Subsection 166.1(5) also places an obligation on the Minister to consider the application "with all due dispatch". This subsection should not be read in isolation as subsection 166.1(7) provides that no application shall be granted by the Minister unless the requirements of that subsection are met. These requirements are:

- The application is made within one year from the time that the notice of objection or request should have been made.
- The taxpayer demonstrates each of the following:
    - within the time limit otherwise provided by the *Act* the taxpayer was either unable to act or to instruct someone else to act on his or her behalf or the taxpayer had a *bona fide* intention to object or make another request;
    - it would be just and equitable to grant the application given the reasons set out in the application; and
    - the application must made as soon as circumstances permitted.

The criteria found in the case law dealing with former subsection 167(5) will be of assistance. In addition, the taxpayer is not required to show that there are reasonable grounds for the objection.

The requirements do not relate to the substantive issues contained in the assessment, but rather, relate solely to the reasons why the taxpayer was unable to object or request a GAAR adjustment within the time limits set out in the *Act*. Conversely, even if the taxpayer has valid grounds for objecting, he or she must still come within the requirements of the subsection.

Subsection 166.1(3) mandates that the application must be addressed to the Chief of Appeals in a District Office or a Tax Centre and must be delivered or mailed. In addition, that subsection requires that the notice of objection or request be included with the application. As a result, even though the substantive issues are not relevant to the granting of the application, the issues must be considered and documented by the advisor when preparing the application. Subsection 166.1(4) does permit the Minister to accept an application even though it is not made in the manner set out in subsection (3).

8.2 Getting a Response

Subsection 166.1(5) requires the Minister to notify the taxpayer of the decision in writing. If the Minister approves the application, the notice of objection or the GAAR adjustment request will be deemed under subsection 166.1(6) to have been served or made on the day on which the notice of the Minister's decision is mailed to the taxpayer. The Minister is no longer required to notify the taxpayer by registered mail.

Subsection 166.1(7) states that it must be just and equitable to grant the application based on the "reasons set out in the application". As a result, it is crucial to include in the application all relevant information. There is no guarantee that Canada Revenue Agency will contact the taxpayer if information is missing. In fact, Canada Revenue Agency typically will make its decision based solely on the contents of the application.

8.3 Court Relief

If the Minister refuses the application, then the taxpayer may apply to the Tax Court under section 166.2 to have the time limit extended. The taxpayer may also apply to the Court if the Minister has not responded to the application within 90 days of service of the application. An application under section 166.2 is made by filing three copies of the documents filed under section 166.1 with the Registry of the Tax Court. Three copies of any refusal notification issued by Canada Revenue Agency must also be filed.

Subsection 166.2(5) is virtually identical to subsection 166.1(7). As a result, the basis for granting an extension of time by the Tax Court is identical to the basis on which the Minister will grant an extension of time. An application to the Court gives an opportunity to bring forward information that was missing in the application to the Minister. This information should be included in documents filed with the Court at the time that the application to the Court is made. The Court will not grant the extension unless it is satisfied that the requirements set out in section 8.1 of this paper are met. See *Consultation Next Step Inc.* 2009 TCC 410.

Subsection 18(1) of the *Tax Court of Canada Rules* (informal procedure) provides that the form for an extension of time application to the Court may be as set out in Schedule 18(1) to the Rules. Section 2 of the *Tax Court of Canada Rules* provides a definition for the term "registry".

The determination of the Tax Court is final, subject only to judicial review by the Federal Court of Appeal under section 28 of the *Federal Courts Act*. The effect of section 18.5 of the *Federal Courts Act* is that, where an Act of Parliament makes express provision for an appeal to a particular court, no alternative appeal may be launched. In other words, if the taxpayer is unhappy with the Minister's decision, the taxpayer must follow the rules set out in section 166.2 to obtain relief.

9. The Appeals Renewal Initiative

On April 17, 1997 the Department of National Revenue announced improvements to the tax dispute resolution process. As a result of this "appeals renewal initiative", the Appeals officers are to make all relevant documents available at the outset of the objection stage to help taxpayers gain a better understanding of the Agency's assessment. Appeals officers also receive additional training to assist them in maintaining clear and open communications with taxpayers throughout the process of resolving their dispute. The Appeals Branch and the Verification, Enforcement and Compliance Research Branch of Canada Revenue Agency have also concluded a protocol designed to confirm the Appeals officers' independence in decision making. Finally, the Appeals Branch, in conjunction with the Departments of Finance and Justice, reviews from time to time the present constraints on settlements and the ability to resolve cases using alternative dispute resolution techniques such as mediation. To date, such techniques have not been adopted as a regular practice.

10. Waiver of Objecting Rights

Subsection 169(2.2) of the Act indicates that a taxpayer is precluded from challenging a reassessment by way of appeal if rights are waived. The scope of the waiver must be examined carefully. See *Pearce* 2005 D.T.C. 199 (T.C.C.).

11. Provincial Objections

Québec and Alberta (corporate only) are the only remaining non-agreeing Provinces in that CRA does not administer the provincial income tax statutes for them. It is only necessary for a taxpayer to file a Notice of Objection in respect of the provincial portion of the reassessment when a non-agreeing province levies an assessment. For example, Alberta's new tax rules for filing Notices of Objection by large corporations became effective September 1, 2007.

Prior to September 1, 2007, a large corporation that filed a Notice of Objection for federal tax purposes within the required timeline was deemed to have filed a similar Notice of Objection with Alberta under subsection 48(1.111) of the *Alberta Corporate Tax Act* (the "Alberta Act"). (Generally, a large corporation is defined in subsection 225.1(8) of the *Act* as a corporation that has taxable capital employed in Canada of more than $10 million.)

Effective September 1, 2007, subsection 48(1.111) of the Alberta Act was repealed, and subsection 48(1.01) became effective which requires Alberta "large corporations" to file a separate Alberta Notice of Objection within 90 days of the mailing of its Alberta Notice of Assessment.

Requirements for Valid Notice of Objection

For a notice of objection to be considered valid, a large corporation must:

- Reasonably describe each issue to be decided
- Specify the relief sought for each issue
- Provide facts and reasons relied on by the corporation for each issue.

It is not uncommon for corporations to miss the Alberta deadlines. In such circumstances, taxpayers will seek an extension of time to file with the provincial authorities.

PART VIII - COLLECTIONS

1. Background

The people from whom Canada Revenue Agency can collect a tax debt may be placed into three groups:

- the tax debtor;
- persons paying amounts to the tax debtor; and
- persons jointly and severally liable with the tax debtor.

This section of the paper focuses on the provisions of the *Act* which relate to Canada Revenue Agency's ability to collect tax debts. Canada Revenue Agency may also proceed outside the *Act* to collect a tax debt. Canada Revenue Agency may use company acts (oppression remedy), or fraudulent preference or conveyance legislation. However, Canada Revenue Agency has a preference for using the provisions of the *Act*. In fact, the provisions of the *Act* have been designed to help Canada Revenue Agency overcome some of the difficulties it may encounter when proceeding outside the *Act*. It is usually only in the context of a bankruptcy in which Canada Revenue Agency operates outside the *Act*. Under those circumstances, Canada Revenue Agency often has no choice but to rely on its remedies found in the *Bankruptcy and Insolvency Act*.

Income tax debts can become statute-barred from collection by virtue of section 32 of the *Crown Liability and Proceedings Act*. See *Markevich v. The Queen* 2003 SCC 9. The effect of this decision has been moderated by legislation (section 222 of the *Act*) with retrospective effect, creating a 10 year limitation period running from at least March 4, 2004, regardless of the date the debt arose. Taxpayers have tried to challenge the retrospectivity without any success (*Collins* 2005 D.T.C. 5679).

Challenges to the improper exercise of collection powers are undertaken through judicial review in the Federal Court of Canada (section 18.1 of the *Federal Courts Act*). However, if an assessment of a taxpayer is involved, section 18.5 may bar the use of judicial review pending the resolution of the taxpayer's appeal in the Tax Court of Canada. For a thorough discussion of this

issue, see *Addison & Leyen Ltd. v. The Queen* 2006 FCA 107. The decision involved a judicial review application based on an allegation of an improper exercise of the Minister's discretion to assess a person's vicarious tax liability under section 160 of the *Act*. See also *Walker v. The Queen* 2005 FCA 393, which stated that the Federal Court does not have jurisdiction to challenge the underlying assessment on which the collection measures are based. In *Addison*, the F.C.A. stated that despite section 18.5, it might quash a reassessment in extraordinary circumstances where section 160 was involved.

2. Collecting from the Tax Debtor

2.1 Nature of the Debt

The tax debt is created by the *Act* itself and not by the notice of assessment or reassessment. The *Act* sets out the dates on which payments are required to be made on account of these debts. As the debt is created by the *Act*, the Minister is entitled to take collection action, subject to the restrictions in section 225.1, on any unpaid balance of taxes, interest and penalties.

The opening section of the collection portion of the *Act* is section 222. That section provides that all tax, interest, penalties, costs and other amounts payable under the *Act* are due to Her Majesty. The section goes on to state that these amounts are recoverable in the Federal Court of Canada or any other court of competent jurisdiction or "in any other manner provided in this *Act*". Thus, section 222 sets out the procedures by which Canada Revenue Agency can collect on tax debts in the Courts or in other manners.

Section 222.1 permits Canada Revenue Agency to use the collection procedures sets out in the *Act* for litigation costs awarded to Canada Revenue Agency as if the costs were a "debt owing by the person to Her Majesty on account of tax payable by the person under this Act".

2.2 Certification

Section 223 provides a quick and easy way for Canada Revenue Agency to turn an amount payable into a judgment. Under this section, the Minister is permitted to file a certificate with the Federal Court certifying that there is an outstanding "amount payable" under the *Act*. The certificate issued by the Court gives Canada Revenue Agency the status of a judgment creditor without the onerous requirement of entering into litigious proceedings. Canada Revenue Agency's ability to collect on its judgment is restricted by section 225.1, which essentially permits a taxpayer to exhaust his rights of objection and appeal under the *Act* before Canada Revenue Agency ultimately collects on the tax debt. Obtaining a certificate does not guarantee Canada Revenue Agency that it will collect. In *Deputy Sheriff v. Canada* (1989) 39 B.C.L.R. (2d) 41, the Court confirmed that the position of Canada Revenue Agency is that of an unsecured judgment creditor. However, the Court went on to state that as a result of the traditional Crown prerogative, the Crown had priority over creditors of equal degree. Accordingly, Canada Revenue Agency was successful in asserting priority over the Royal Bank, another judgment creditor.

2.3 Memorials

Once Canada Revenue Agency has obtained a certificate, it may then use the certificate to bind the land owned by the taxpayer. Under the provisions of subsection 223(5), the certificate now purports to have the same effect as a judgment of a superior court of a province. Once the certificate is filed, it is referred to as a "memorial" and under subsection 223(6), the *Act* creates a charge or lien on the land "in the same manner and to the same extent as if the memorial were a document evidencing a judgment".

Prior to the addition of this language, the opposite conclusion was reached by the New Brunswick Court of Appeal in *Great-West Life Assurance Co. v. Canada* (1987), N.B.R. (2d) 423. In that case, Canada Revenue Agency used a certificate as described above to proceed under the *Provincial Memorials and Executions Act*. The Court held that the certificate was not a "memorial of judgment" within the meaning of that statute.

It should be noted that the memorial provisions in subsections 223(5) and 223(6) represent an intrusion into the powers and procedures of the provincial superior courts and their land registry systems. Where the property involved is of significant value, one might consider a challenge on constitutional grounds.

2.4 Set-Off

Another method of collecting from the tax debtor is through a deduction or set-off. Although deductions and set-offs exist at common law and under a variety of statutes, Canada Revenue Agency has the benefit of section 224.1. Under section 224.1, Canada Revenue Agency can set off for the tax debt against any amount "that may be or become payable to the person by Her Majesty in Right of Canada". This typically arises where the tax debtor is also doing business with the federal government. Rather than pay the tax debtor under the agreement with the federal government, Canada Revenue Agency will set off the amount payable under the agreement against the tax debt. This often occurs without any notice to the tax debtor. For an analysis of this section, see *Clarkson Co. Ltd. v. The Queen* 89 D.T.C. 5050 (F.C.A.). In that case, the Court confirmed that, in general, the section still requires that the relevant debts be "mutual" in the sense that they arise between the same parties. Presumably, this requirement has been expressly overridden by section 224.1 as it also includes amounts payable as a result of a provincial tax debt.

Based on the main issue in the *Clarkson Co.* decision, one might consider a review of the contract with the federal government. It may well be that the timing of the existence of the debt gives priority to someone other than Canada Revenue Agency under section 224.1.

2.5 Foreclosures

Section 224.2 permits the Minister to participate in foreclosure and similar proceedings. The Minister may purchase or acquire any interest in the tax debtor's property pursuant to a right given to the Minister under those proceedings. The use of section 224.2 is not specifically restricted under section 225.1. However, paragraph 225.1(1)(a) restricts the Minister's ability to "commence legal proceedings in a court" and accordingly, the Minister is effectively prevented

from initiating a foreclosure proceeding during the period in which collection restrictions are applicable. If, however, the foreclosure proceedings are commenced by someone else, it appears the Minister will be entitled to participate under section 224.2.

Under section 225, the Minister may seize and sell a tax debtor's personal property. All that is required under section 225 is thirty days' written notice before the power to seize can be exercised. After the property has been seized, it may be sold by public auction if the tax debtor does not pay the amount due within ten days. Under subsection 225(5), Canada Revenue Agency may not seize personal property that would be exempt from seizure by writ of execution issued by a provincial superior court.

Finally, under section 226, the Minister may accelerate collection where the taxpayer is about to leave Canada. Where a taxpayer fails to pay as required, the Minister may direct the seizure of the taxpayer's personal property under section 225. Once again, section 226 is not expressly restricted under section 225.1. Note that section 226 applies not only to taxpayers who are about to leave Canada but those who have already left. The fact that section 226 is not included in the restrictions in section 225.1 does not mean that the Minister can necessarily collect. The section merely accelerates the time for payment and accelerates the due date of a tax liability and that is a wholly different matter than permitting Canada Revenue Agency to collect on the debt.

3. Collecting from Persons Paying Amounts to the Tax Debtor

3.1 Garnishment

In sections 224 through 224.3, Canada Revenue Agency has both a garnishment provision and a "super priority" provision.

A broad garnishment power was given to Canada Revenue Agency as far back as in the 1917 *Act*. The garnishment provision in the *Act* is once again much simpler than the garnishment provision available to other creditors. Rather than proceeding through the court system, Canada Revenue Agency simply makes a demand more commonly referred to as a "requirement to pay" under section 224. Canada Revenue Agency issues these demands using a standard form T1118. If a lawyer or client receives a demand, determine if it has been signed by a person authorized under subsection 220(2.01). If it has, then advise the client to comply with the demand. Failure to comply exposes the recipient of the demand to liability under subsection 224(4) or (4.1) for the full amount demanded by Canada Revenue Agency. Subsection 224(2) attempts to provide the recipient with some protection against a claim by the debtor. That subsection provides that the "receipt of the Minister for moneys paid as required under this section is a good and sufficient discharge of the original liability to the extent of the payment." Presumably, if the recipient and the tax debtor litigated the issue, this provision would be part of the recipient's defence. Under subsection 224(1), the Minister may issue a demand not only on a person who is liable to make a payment to a tax debtor but also on a person who "will be within one year" liable to make a payment to a tax debtor.

3.2 Demands on Financial Institutions

Under subsection 224(1.1), Canada Revenue Agency may issue a demand on a financial institution. This subsection permits Canada Revenue Agency to obligate the financial institution to pay over loan proceeds to Canada Revenue Agency on account of the tax debtor's tax liability. The subsection is quite broad. If an advisor is acting for a financial institution, he or she should carefully determine whether the financial institution is within the subsection even though it is advancing loan proceeds to someone other than the tax debtor.

An issue which also has arisen frequently is whether Canada Revenue Agency can issue a demand on a trustee of a registered retirement savings plan ("RRSP"). A series of older decisions held that Canada Revenue Agency could, through the use of subsection 224(1), garnish a tax debtor's RRSP. See *MNR v. Gero* 79 D.T.C. 5228 (F.C.T.D.); *National Trust Co. Ltd. v. Lorenzetti et al.* 41 O.R. (2d) 772 (S.C.O.); and *The Queen v. Rumball and Pioneer Trust Company* 81 D.T.C. 5001 (F.C.T.D.). However, more recent decisions have concluded that an RRSP is a relationship of trustee and beneficiary rather than one of debtor and creditor (except in Quebec), with the result that the trustee of the RRSP is not a person "liable to make payment" for purposes of the garnishment provisions in the *Act*. See *Morgan Trust Co. v. Dellelce* 85 D.T.C. 5492 (S.C.O.); *DeConinck v. Royal Trust Corp.* [1989] 1 C.T.C. 179 (N.B.C.A.); and *Manufacturers Life Insurance Co. v. MNR* 91 D.T.C. 1055 (T.C.C.). Compare *Marrazza* 2004 D.T.C. 6089 (F.C.). This is of little consolation to taxpayers in most provinces, where an RRSP is subject to seizure by Canada Revenue Agency pursuant to a writ of execution even if not subject to garnishment. See *Morgan Trust Co. v. Dellelce*, supra; *Bank of British Columbia v. 225280 B.C. Ltd.* 65 B.C.L.R. 23 (B.C.S.C.); *Re Bodnarchuk* 95 D.T.C. 5500 (F.C.T.D.).

As a result of a 2008 amendment to the *Bankruptcy and Insolvency Act* (s.67), RRSPs and RRIFs will now be exempt from creditors except for contributions made 12 months before bankruptcy.

3.3 Super Priority

Perhaps one of the more controversial provisions in the *Act* is subsection 224(1.2). Under this provision, Canada Revenue Agency is given a super priority over secured creditors where a demand on a secured creditor has been made. Subsection 224(1.2) has gone through many different forms as financial institutions and other creditors have at times challenged its scope and constitutional validity. This section deems any money which is the subject of the demand to be property of Her Majesty "to the extent of that liability as assessed by the Minister and shall be paid to the Receiver General in priority to any such security interest". As a result, when acting for a creditor, a review of the tax position of the debtor is critical to ensure that any security taken by the creditor will not be overridden by this super priority. As a result of the decision by the Supreme Court of Canada in *Royal Bank of Canada v. Sparrow Electric Corp.* 97 D.T.C. 5089, amendments were made effective from June 15, 1994 to strengthen the Crown's priority claims.

In addition, when acting for a creditor, the tax professional should advise the creditor of the existence of subsections 227(5) to (5.2). Those subsections provide that where a "specified person" administers, winds up, controls or otherwise deals with the business, income or property of another person, then the specified person becomes liable for the withholdings pursuant to

subsection 153(1). Without these provisions, Canada Revenue Agency would be left to collect against a tax debtor who is obviously in financial difficulty. The definition of "specified person" includes trustees, interim receivers, secured creditors and agents of those persons. These persons need not be acting in a fiduciary capacity to attract source deduction liability. Section 153 also imposes source deduction liability on secured creditors who interfere with the issuance or clearance of a taxpayer's remittances. Apparently, Canada Revenue Agency has seen a number of instances where to improve the tax debtor's cash flow, the financial institution will not clear the cheque to the Receiver General but will clear the cheque for the net amount paid to employees. The Department of Finance apparently hopes that the effect of this amendment will be to force banks to advance the full amount of a payroll inclusive of source deductions.

For a discussion of subsection 227(4.1) and interaction with 224(1.3), see *Caisse Populaire Desjardins de L'Est de Drummond* 2009 D.T.C. 5106 (SCC).

4. Collecting from Third Parties

Generally there are two ways in which Canada Revenue Agency can collect from third parties: director's liability (section 227.1) and transferee liability (section 160).

4.1 Directors' Liability

4.1.1 Prerequisites

Director's liability for unremitted source deduction including income tax, CPP and EI first came into the *Act* in the early 1980s. The inclusion of director's liability under the *Act* was part of a larger move generally by legislatures to increase director's civil liability to a variety of creditors of the corporation. Director's liability has been subsequently expanded to include Part VII and Part VIII tax of the corporation. Liability is placed on a director under section 227.1. A director may be liable in three situations:

- where the corporation has failed to deduct or withhold source deductions or non-resident withholding tax;
- where the corporation has failed to remit source deductions or non-resident withholding tax; or
- where the corporation has failed to pay Part VII or Part VIII tax.

At the moment one of these three failures occurs, the directors are jointly and severally liable with the company to pay the amount. The director is also liable for any interest or penalties relating thereto. The liability exists without the issuance of an assessment. When acting for a director or advising a soon to be director, make it clear that these events may occur within the corporation without his or her knowledge and he or she may become liable without any notice from Canada Revenue Agency.

4.1.2 Defences

There are a variety of procedural and substantive defences possibly available to a director facing liability under section 227.1.

(a) Subsection 227.1(2)

Under subsection 227.1(2), a director is not liable unless one of three events occurs. These events are:

- that Canada Revenue Agency has certified the corporation's liability in Federal Court under section 223;
- the corporation has commenced liquidation or dissolution proceedings; or
- the corporation has made an assignment or a receiving order has been made against it under the *Bankruptcy and Insolvency Act*.

Accordingly, one must first determine whether one of these three events has occurred. At a trial, Canada Revenue Agency must establish that one of these three events occurred. The evidentiary requirement for Canada Revenue Agency to establish that one of the these events has occurred should be kept in mind.

(b) Due Diligence

Under subsection 227.1(3), a director may also defend against his or her liability on the basis that he exercised the "degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances". In the last ten years, there have been a great number of cases dealing with this "due diligence defence". One argument to consider is whether a lower than usual standard applies to a specific director. A useful discussion of this area is found in *Soper v. MNR* 97 D.T.C. 5407 (F.C.A.).

Soper dealt with a taxpayer who was not an inside director but who was an experienced businessman. Even after seeing a balance sheet that indicated the corporation was experiencing financial difficulty, Soper did not enquire into whether remittances were being made. The F.C.A. concluded that he had failed "to exercise the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances." Because the jurisprudence had not established guidelines for this due diligence defence, the F.C.A. embarked on a lengthy inquiry into the appropriate standard. Mr. Justice Robertson concluded that "[t]he standard of care is inherently flexible. Rather than treating directors as a homogenous group... the provision embraces a subjective element that takes into account the personal knowledge and background of the director, as well as his or her corporate circumstances in the form of, inter alia, the company's organization, resources, customs and conduct." The F.C.A. said that inside directors will have most difficulty meeting the test and arguing that they lacked business acumen. However, the F.C.A. referred with approval to the companion case of *Sanford* in which an inside co-director was exonerated apparently because of her limited financial experience and restricted influence on corporate management. In contrast, Canada

Revenue Agency's circular IC 89-R2 does not seem to accept this position because it does not distinguish between directors, be they passive, nominee or outside directors.

The F.C.A. also specifically referred to positive steps for due diligence said to be required in IC 89-R2—namely, setting up controls to account for remittances, asking for regular reports thereon and obtaining confirmation that withholding the remittances has occurred. The F.C.A. concluded that these steps may be persuasive evidence of due diligence but they are not necessary to successfully establish the defence, in particular the requirement for a trust account. The F.C.A. also said that a passive director may rely on day-to-day management to meet the remittance obligation, unless "there is reason for suspicion". For example, if the company is having financial difficultly, there is a duty to take positive steps. The *Soper* reasoning was adopted in *Smith* 2001 D.T.C. 5226 (F.C.A.), *Cameron* 2001 D.T.C. 5045 (F.C.A.), and *McKinnon* 2000 D.T.C. 6593 (F.C.A.) among other cases.

On October 29, 2004, the Supreme Court of Canada released its judgment in *Peoples Department Stores v. Wise* 2004 SCC 68. It concluded that the *Soper* test was not accurate, that only an objective standard should be utilized and that everything must be considered on a case by case basis (para. 63). The Supreme Court gave permission to take into consideration relevant subjective factors. Yet see *Savard* 2008 TCC 309, where a director was liable for taxes not remitted during the period in which the corporation was operating pursuant to a proposal under bankruptcy legislation. See also *Liddle* 2009 D.T.C. 1296 and *Campbell* 2010 TCC 100 which applied the *Soper* standard.

The Tax Court determined in *McKinnon* 2004 D.T.C. 2049 that a director is only required to act reasonably in the circumstances. If efforts are unsuccessful it does not mean that the director failed to act reasonably.

(c) Due Diligence - The Passive Director

Another way in which a lower of standard of care may apply to a director is if a director was a "passive director". This often applies to spouses otherwise uninvolved in a business. The *Soper* decision addressed the circumstances in which a passive director may be liable. The decision in *McCandless v. The Queen* 95 D.T.C. 484 is also noteworthy. In that case, the taxpayer was a lawyer who acted as nominal director so that the company could meet the residency requirements under the relevant corporate statute. The taxpayer's appeal was dismissed because the Court found that he took no real steps to ensure that source deductions were remitted. His position as a nominal director did not operate to relieve him of his obligations under the *Act*. There have also been cases where spouses who acted as passive directors have been relieved of liability. See *Robitaille* 90 D.T.C. 6059 (F.C.T.D.); *Clark* 90 D.T.C. 1094 (T.C.C.); *Danielson* 86 D.T.C. 6518 (F.C.T.D.); *Pilling* 89 D.T.C. 327 (T.C.C.); *White* 95 D.T.C. 877 (T.C.C.); and *Dumont* 95 D.T.C. 804 (T.C.C.).

Canada Revenue Agency has also been assessing "de facto" directors with some success. See *Wheeliker* (99 D.T.C. 5658 (F.C.A.), leave to Supreme Court of Canada denied), *Parisien* 2004 TCC 276, *Bremner* 2007 TCC 509, *Liddle* 2009 D.T.C. 1296 and *Campbell* 2010 TCC 100. An extensive discussion is in *Scavuzzo* 2006 D.T.C. 2136 (T.C.C.) which also deals with contesting the vicarious liability by contesting the primary liability. Yet compare *Netupsky* 2003

G.T.C. 591 (T.C.C.) regarding the lack of a "de facto" director where the only director had resigned.

(d) Not a "Director"

Another defence which might be raised is that the taxpayer was not a "director" within the meaning of that word in the *Act*. There are a number of variations of this defence, all of which result because the *Act* does not define "director". The starting point for the Court has generally been a review of the relevant corporate statute.

One of the first cases to consider this defence was *Parsons v. MNR* 83 D.T.C. 5329 (F.C.T.D.). In that case, the Court established that the word "director" is a term of art and accordingly, has a technical meaning in respect of corporations. In *Dewitt v. MNR* 90 D.T.C. 1027 (T.C.C.), the individuals in question were successful in arguing that they were not directors under the relevant corporate statute. The Court reviewed the *Alberta Business Corporations Act* and determined that that statute required the consent of the individual before that individual could become a director. The individuals involved were able to establish that they had never consented to becoming directors and never exercised any of the powers associated with being a director. As a result, the Court found that the individuals were not directors within the meaning of the Alberta statute. *DeWitt* may be contrasted with the decision in *Irvine v. MNR* 91 D.T.C. 91 (T.C.C.), where the Court held that the *Saskatchewan Business Corporations Act* did not require consent of the individual.

(e) Resignation

There have also been a series of cases in which the individual has argued that he or she has "resigned" as a director. In this regard, the Courts have held that the individual must strictly follow the requirements of the corporate statute. In *Cybulski v. MNR* 88 D.T.C. 1531 (T.C.C.), the Court held that the individual was still a director because the *Business Corporations Act of Ontario* did not permit a director to resign unless at the time of the resignation a successor had been elected or appointed. In *Hawkins v. MNR* 91 D.T.C. 648 (T.C.C.), the Court found that the individual had not resigned because the resignation was not in writing to the corporation. In *Pidskalny v. MNR* 91 D.T.C. 1046 (T.C.C.), the individual's written resignation was found to be ineffective because he had not delivered it to the corporation's registered office as required by the British Columbia corporate statute.

(f) Ceased to Be a Director

Taxpayers have had more success, especially lately, in arguing that their powers as directors have been removed by certain events. Typically, this occurs where the normal powers of the directors have vested in a liquidator or a receiver-manager. The leading case in this regard is *Robataille v. The Queen* 90 D.T.C. 6059 (F.C.T.D.). Following up on comments made in the *Lindthaler* decision, Addy J. stated at page 6062 as follows:

> "... even without considering section 227.1(3) there would be no liability on the directors under section 227.1 because the latter obviously contemplates the corporation as freely acting through its

> board of directors. The exercise of freedom of choice on the part of the director is essential in order to establish personal liability."

In *Perri v. MNR* 89 D.T.C. 723 (T.C.C.), section 110 of the former *British Columbia Company Act* came to the rescue of the individual. That section provided as follows:

> "Where a receiver manager is appointed the powers of the directors and officers of the corporation cease with respect to that part of the undertaking for which he is appointed until he is discharged."

Unfortunately in *Kalef v. the Queen* 96 D.T.C. 6132, the Federal Court of Appeal held that the taxpayer had not ceased to be a director on the date a trustee in bankruptcy exercised its powers to control the company's assets. See *The Queen v. Aujla* 2008 FCA 304 regarding the liability of a director if a corporation is restored after being struck off.

(g) Subsection 227.1(4) - No Action or Proceeding

Subsection 227.1(4) provides as follows:

> "No action or proceeding to recover any amount payable by a director of a corporation under subsection (1) shall be commenced more than two years after the director last ceased to be a director of that corporation."

The leading case on the meaning of the phrase "no action or proceeding to recover" is *Manago v. MNR* 90 D.T.C. 1889 (T.C.C.). In that case, the Court held that the issuing of a notice of assessment was sufficient. I have written elsewhere that this may not necessarily be correct and I doubt that *Manago* and other cases that have followed *Manago* are the last word on the meaning of "action or proceeding to recover". In any event, subsection 227.1(4) does present a defence for an individual facing liability. Following the discussion above of what is a "director", one must first determine when the individual ceased to be a director. If Canada Revenue Agency has not commenced an action or proceeding to recover within two years of that date, the individual is not liable. Although *Manago* held that a notice of assessment was an action or proceeding, in *Osborne v. MNR* 91 D.T.C. 1283 (T.C.C.), the Court held that a letter written by Canada Revenue Agency to the taxpayer advising him of the potential liability was not sufficient to constitute an action or proceeding to recover.

Measurement of the two-year period must be done with reference to subsection 27(5) of the *Interpretation Act*. See *Larocque* [1991] 2 C.T.C. 2151 (TCC).

(h) Adequacy of Notice - *Leung*

The adequacy of a notice of assessment was at issue in *The Queen v. Joseph Leung* 93 D.T.C. 5467 (F.C.T.D.). In that case, Mr. Leung was successful at the Tax Court in arguing that the notice of assessment was not valid because it failed to separate out the different statutes under which Mr. Leung was held to be liable. The Federal Court-Trial Division held that Canada Revenue Agency had fulfilled its duty. Mr. Justice Joyal stated as follows:

> "Sections 152(3), 152(8) and 166 combine clearly to indicate that this error by the Minister of National Revenue is far from fatal; the cases only limit these sections where there is substantial and fundamental error; in such cases, the Court will not allow the Minister to hide behind the provisions."

The Court went on to point out that to succeed on the argument that the notice of assessment was invalid because of its shortcomings, the taxpayer had to show that it had been prejudiced by the shortcomings. In *Leung*, the taxpayer was unable to show prejudice essentially because it was fairly easy to determine under which statutes the taxpayer was liable.

(i) Does the Corporation Owe Any Amounts?

The director may challenge the assertion by CRA that the corporation of which he/she was a director owed any amounts to CRA. See Barry 2009 TCC 508 summarizing the conflicting jurisprudence.

4.2 Section 160

Section 160 has recently been acknowledged by the Federal Court of Appeal to be a "harsh collection remedy" for 9 reasons. See *Addison & Leyen Ltd.* 2006 FCA 107, reversed 2007 SCC 33. Therefore, its scope must be well-understood.

4.2.1 Who is Caught?

The basic premise to section 160 is fairly straightforward. Canada Revenue Agency should not be defeated where a tax debtor has given away his or her property. Subsection 160(1) makes a transferee liable for the tax debtor's tax debt.

For the transferee to be liable, he or she must be one of the following:

- the tax debtor's spouse or common law partner or a person who has since become the person's spouse or common law partner;
- a person who is under 18 years of age; or
- a person with whom the tax debtor was not dealing at arm's length.

This will even catch a transfer to a spouse's self-directed RRSP (*Woodland* 2009 D.T.C. 1291). There are some subtle points of which to take note. First, one must carefully review the definition of "common law partner" contained in subsection 248(1). In some situations the transferee may not be a common law partner, but may still be a "non-arm's length" person. The transferee under 18 years of age does not have to be related or deal at non-arm's length with the tax debtor.

Only certain transfers occurring as part of a marital breakdown are also excluded. Subsection 160(4) of the *Act* provides that an ex-spouse is not liable under subsection 160(1) in the following circumstances:

- the transfer occurs as a result of a decree, order, judgment or pursuant to a written separation agreement; and

- the transfer occurred at a time when the taxpayer and the spouse were living separate and apart.

This provision does not immunize property transferred in these circumstances from seizure to satisfy the liability of the transferee under section 160 arising from pre-matrimonial breakdown transfers.

Section 160 also does not provide any protection for transfers made in the context of a matrimonial property settlement. An example where that type of protection would be beneficial is where the tax debtor settles a family trust in favour of his or her children or certain corporate reorganizations occurring before, during or after a matrimonial breakdown without protection of subsection 160(4) of the *Act* (e.g., a butterfly).

4.2.2 What is Caught?

Under subsection 160(1), a "transfer of property" is the event which triggers transferee liability. The meaning of these words is discussed below. The concept of transferee liability was expanded in sections 160.2 and 160.3 to include amounts paid from deferred income arrangements such as RRSPs, RRIFs and RCAs. These types of arrangements were not previously caught because the property received by the transferee was transferred by a trustee.

It is also important to note that the transferee is only liable to the extent that the lesser of the transferor's tax liability for the year and the value of the property received exceeds the value of the consideration given.

4.2.3 Transfer of Property

Section 160 only applies where there has been a "transfer of property". This is a broad concept which can include dividends or services for inadequate consideration (see *Addison & Leyen Ltd., supra*). The term "transfer" within the *Act* has been given a wide meaning by the courts. The leading case on the meaning of the word is *Estate of David Fasken v. M.N.R.*, 49 D.T.C. 491 (Ex. Ct.). That decision was applied to the section 160 context in *Furfaro - Siconolf v. The Queen*, 90 D.T.C. 6237 (F.C.T.D.) where at 639 the Court stated as follows:

> "I consider that the transfer of property contemplated by s. 160 of the *Act* is a simple transfer of ownership, without it being necessary for the recipient to have possession of a thing or object the ownership of which is thus transferred. In a precise definition, the underlying Income Tax Act recognizes the "property" includes a right of any kind whatever, and consequently the right of ownership of a thing."

Although the meaning of the word "transfer" has become quite wide, taxpayers have had some success in arguing that no transfer exists. For example, in *Miller v. M.N.R.*, 88 D.T.C. 1488 (T.C.C.), the taxpayer argued successfully that only bare title had been transferred and not

beneficial ownership. An alternative way of framing this argument is to state that bare title has little value and accordingly a transfer of legal title almost by definition is for adequate consideration. Yet see *Livingston* 2007 FCA 89, *Gambino* 2008 TCC 601 and *Rose* 2009 FCA 93. The existence of a resulting trust will also preclude the application of section 160 (*Warren* 2009 D.T.C. 1024 (T.C.C.)).

Perhaps the most interesting issue under section 160 involves the payment of a dividend as a "transfer of property" for no consideration. If it is a transfer of property, then a shareholder may become liable for the tax debts of the corporation. The first decision on this issue was *Fournier v. M N.R.*, 91 D.T.C. 746 (T.C.C.). The decision in *Fournier* depends mostly on whether the shareholder acted in an arm's length relationship with the corporation. The Court held that he did not and thus the taxpayer was held liable for the corporation's tax debt. A variation on the decision in *Fournier* was reached in *Algoa Trust v. The Queen*, 93 D.T.C. 405 (T.C.C.). In that case, the Court held that a stock dividend was not a "transfer of property." In *Davis v. M.N.R.* 94 D.T.C. 1934, the Tax Court held that, on specific facts, a dividend was not a transfer of property because it was compensation for work done for the company. In *Davis* the taxpayers had not taken salary in the initial start-up years of the company and subsequently were paid by way of dividend. By contrast, Mr. Justice Bell decided that two corporate taxpayers which received substantial dividends from a wholly-owned subsidiary "to a debtor" could be liable under section 160 of the Act (*155579 Canada Inc. et al.*, 97 D.T.C. 691). See also *Therrien* 2005 D.T.C. 176 (T.C.C.), *Gilbert* 2005 D.T.C. 1579 (T.C.C.), affirmed 2007 FCA 136, *Neumann* 2009 DTC 1087 (TCC), *Gestion André Pomerleau Inc.* 2008 CCI 539 (TCC) and 2753-1359 *Quebec Inc.* 210 FCA 32. As a result of these decisions, it is fair to say that this area of the law is now settled. The F.C.A. in *Addison & Leyen Ltd.* also confirmed that *Algoa Trust* remains the law for now. There are three issues which the courts have examined. The basic issue in these cases is whether the declaration is a transfer of property. Generally speaking, the declaration of a dividend creates a simple debt from the corporation to the shareholder. Second, is the payment of the dividend in satisfaction of the debt is a transfer of property? Presumably, the payment of the dividend is not a transfer of property because the debt already exists. Third, is the declaration of a dividend a transfer of property for valuable consideration, namely the surrender of or satisfaction of rights to receive dividends? In *Gilbert*, supra, the fair market value of the dividends was to be reduced by the tax payable by the recipients.

CRA has also applied section 160 to a corporate taxpayer as a result of a subscription for shares in that company by an alleged tax debtor. See *Pendico Investments* (Court File 2004-361(IT)G) (T.C.C.).

"Cascading" or "secondary" assessments are not prohibited. See *Jurak* 2003 D.T.C. 5419 (F.C.A.) and *Addison & Leyen Ltd., supra.* Previously, in *M. Nanini v. M.N.R.*, 94 D.T.C. 1839 (T.C.C.), a dividend was passed up through a series of holding companies. Canada Revenue Agency reassessed the "grandparent" company. The Court held that the taxpayer was not liable because neither the transferor nor the "parent" company had a liability for unpaid taxes at the time that the transfer occurred. The Tax Court determined that the wording of section 160 at that time was specific in that it only applied to the transferee where a transferor had a liability for unpaid taxes.

4.2.4 Consideration

The final prerequisite for the application of section 160 is that the transferee must not have paid adequate consideration for the property. "Family/household obligations" do not seem to count, though the surrender of rights under or pursuant to the execution of a marriage contract may suffice. Taxpayers are often creative in arguing they returned something to the tax debtor as "consideration." There are also questions regarding the fair market value of the consideration.

4.2.5 Does the Transferor Owe Any Amount Under the Act?

The transferor must be liable for an amount in respect of the taxation year in which the property was transferred or any preceding taxation year. Until *The Queen v. Heavyside*, 97 D.T.C. 5026, transferees also argued that they were not liable for a transferor's debt that was extinguished by bankruptcy of the transferor tax debtor. The Federal Court of Appeal has unfortunately decided this issue in favour of the Crown. In any event, it may be possible to argue that the liability of the transferor was incorrectly calculated or assessed (*Thorsteinsson*, 80 D.T.C. 1369 (T.R.B.)). This may prove highly difficult when spouses have separated or divorced.

4.2.6 Summary of Defences

The statutory provisions and the case law give a number of defences to a possible section 160 assessment:

- No transferee is in one of the specified relationships;
- The liability of the transferor is less than assessed;
- The transfer occurred in a year preceding any liability of the transferor;
- The transferee gave adequate consideration;
- No transfer occurred;
- The property was transferred pursuant to marital breakdown.

4.2.7 Limitation on Collection?

Subject to the application of section 222 of the Act, it might be possible to argue in limited circumstances that the transferor's debt has become statute-barred under the CLPA, in accordance with *Markevich* 2003 SCC 9. In September 2003, the Department of Justice announced that the transferee would not be liable for debts of the transferor that had become barred from collection under section 32 of the CLPA where the "transfer" of property occurred after the collection of the debt became statute-barred. Note however that the limitation period for collection of tax debts was retrospectively increased by the amendments to section 222.

A related issue arose in *Madsen* (2004 D.T.C. 3058 (T.C.C.), additional reasons 2005 D.T.C. 369 (T.C.C.), affirmed 2006 FCA 46), where the appellant transferee argued that a section 160 assessment issued more than six years after the transfer of property took place was statute-

barred. The Tax Court, relying on *Markevich*, dismissed the appeal on the basis that any limitation period that might apply to the transferee's tax debt did not start running until 90 days after the assessment was issued.

5. Restrictions On Collection - Section 225.1

An amount payable under a tax assessment, including taxes, interest and penalties, is a debt owing to the Crown which is payable to the Receiver General upon receipt of a notice of assessment or reassessment by the taxpayer (sections 158 and 222 of the *Act).* However, subject to specific exemptions, as a result of subsection 225.1(1), Canada Revenue Agency's ability to collect assessed amounts is severely restricted throughout the 90-day period during which a taxpayer may file a Notice of Objection with Canada Revenue Agency. These restrictions are in place to give the taxpayer time to decide whether he or she should object to the assessment.

Under subsection 225.1(2) these restrictions continue to apply if a Notice of Objection is filed. Essentially, the only measure Canada Revenue Agency is legally able to take during this time is to request payment of assessments from taxpayers in writing or by telephone. Generally, Canada Revenue Agency does not have the right to invoke the full range of collection mechanisms provided in the *Act* at least until the 90th day after the day on which the notice confirming or varying the assessment is mailed to the taxpayer. This 90-day delay is intended to give a taxpayer time to decide whether the response of the Minister to the Notice of Objection should be appealed to the Tax Court. If an appeal is instituted in the Tax Court, Canada Revenue Agency cannot invoke the full range of collection mechanisms provided under the *Act* before the earlier of the day of mailing of a copy of the decision of the Tax Court to the taxpayer, or the day on which the taxpayer discontinues the appeal.

Thus, where a Notice of Objection is filed, the taxpayer may delay paying the amount of an assessment that is in dispute without concern that Canada Revenue Agency will enforce payment of that amount for at least 6 months. If the dispute proceeds to the Tax Court of Canada, an additional delay in payment of at least 135 days (longer if the general procedure is followed) will be available.

6. Jeopardy Collection - Section 225.2

6.1 What is a Jeopardy Collection?

In part to counter the provisions of section 225.1, the *Act* permits Canada Revenue Agency to collect where it believes that collection is in jeopardy (under section 225.2). Where it may reasonably be considered that collection of an amount would be jeopardized by delay, then Canada Revenue Agency may assess and take collection action otherwise proscribed under section 225.1.

6.2 Requirements for Jeopardy Collection

To exercise this discretion, Canada Revenue Agency must first apply *ex parte* to a "judge" (as defined subsection 225.2(1)) and satisfy that judge that collection is in jeopardy. If satisfied, the judge will issue an authorization order setting out the collection action that Canada Revenue Agency may take.

Under subsection 225.2(5), Canada Revenue Agency must then notify the taxpayer in writing within 72 hours of the granting of the authorization. Subsection 225.2(6) provides that the notice must be served personally or in accordance with service requirements in the authorization.

The *Act* does not provide any guidance on when Canada Revenue Agency is in jeopardy of collecting an amount. Presumably, the insolvency of the taxpayer is sufficient for an authorization. Other circumstances in which an authorization may be granted include: evidence that assets are being wasted, the inability to contact responsible representatives of the taxpayer, evidence of asset disposition, aggressive steps taken by creditors and wrongful conduct of directors. Canada Revenue Agency has attempted to invoke the jeopardy collection provisions in section 225.2 in a number of cases, but has not always been successful in persuading a court of the danger of not collecting. See *D.M.N.R. v. Atchison* 89 D.T.C. 5088 (B.C.S.C.), *1853-9049 Quebec Ltd. v. The Queen* 87 D.T.C. 5031 (F.C.T.D.), *Medjick v. Dep. MNR* 97 D.T.C. 5113 (B.C.S.C.), *Services M.L. Marengère Inc.* 2000 D.T.C. 6032 (F.C.T.D.) and *Paryniuk* 2004 D.T.C. 6023 (F.C.T.D.). Also see *Canada (Minister of National Revenue) v. Goldband Jewelers Ltd.* 2006 A.B.Q.B. 108 (F.C.); *Chamas* 2007 D.T.C. 5090. *Canada (National Revenue) v. S&D International Group* 2009 ABQB 536, *Cormier-Imbeault* 2009 D.R.C. 5111 and *Fiducie Dauphin* 2009 D.T.C. 5087.

6.3 Appeal of Authorization

The taxpayer may appeal the authorization to the judge but must do so within strict time limits. Under subsection 225.2(9), the taxpayer must bring an application to review the authorization within 30 days of service. The subsection gives the judge discretion to extend this period. Under subsection 225.2(8), the taxpayer must give 6 clear days notice to the Deputy Attorney General of Canada. Subsection 225.2(13) provides that there is no appeal from this review. Presumably, these rules exist so that the taxpayer may not delay collection by further disputing the order.

For the taxpayer to be successful on appeal, the taxpayer must dispel the grounds for the authorization and as well establish that collection would be, at a minimum, inconvenient. This latter requirement is likely necessary because of the relative leniency granted by section 225.1.

6.4 Practical Issues

The definition of a "judge" gives a tax lawyer the opportunity to have the authorization reviewed in either the Federal Court or the relevant provincial superior court. The advantage of the Federal Court is that it may be easier to obtain a quick court date. The advantage of the provincial court is that litigators tend to be more familiar with the rules of those courts.

The application will proceed summarily which means that there will be no discoveries and no document production. The evidence will be adduced through affidavits, although the Federal Court rules permit *viva voce* evidence with leave. Because the order is final, hearsay evidence in the affidavits is not permitted. An order for cross-examination may be obtained.

Section 225.2 does permit Canada Revenue Agency to undertake collection proceedings while trying to obtain a jeopardy collection authorization. Accordingly, the restrictions in

section 225.1 will not apply. Yet even if Canada Revenue Agency is ultimately successful, Canada Revenue Agency must still follow the rules for collection set out in the relevant sections. For example, to seize personal property, Canada Revenue Agency must give 30 days' notice of the intention to seize.

6.5 Taxpayer Leaving Canada

Section 226 sets out a similar rule, although it does not require an application to the court. Where Canada Revenue Agency suspects that a taxpayer is about to or has left Canada, the Agency may assess the taxpayer. The assessment will direct the taxpayer to pay the amount assessed immediately. Subsection 226(2) permits Canada Revenue Agency to seize personal property of the taxpayer as long as the rules in subsections 225(2) to (5) are followed.

7. Bankruptcy

The *Bankruptcy and Insolvency Act* has provisions relevant to the collection of income taxes. Certain tax debtors may not get automatic discharges (section 172.1). Transfers at under value can be unwound or can result in judgment awarded against a transferee (ss.95, 96 or 98.1).

8. Remission Orders

The following is taken from CCH Tax Topics (July 9, 2009), Number 1948 which reprinted a portion of the text from Innes, Chua and Bissell (*Federal Tax Practice*)

What is a Remission Order?

A remission order s an extraordinary measure to provide complete or partial relief from federal income tax, the Goods and Services Tax (GST), the Harmonized Sales Tax (HST), interest, penalties, and certain other non-tax amounts, such as Canada Pension Plan and employment insurance premiums, when such relief is not otherwise available to taxpayers or GST/HST registrants under the existing tax laws.

Most remission orders relate to a particular person. However, a general remission order may be issued where a group of persons s adversely affected by a certain set of circumstances. An individual remission should not be considered if a person qualifies for the requested relief under a general remission order.

Legal Authority for Granting Remission

Under subsection 23(2) of the *Financial Administration Act*, the Governor in Council, on the Minister's recommendation, may remit tax or penalty, including any related interest, where the Governor in Council considers that "the collection of the tax or the enforcement of the penalty is unreasonable or unjust or that t is otherwise in the public interest to remit the tax or penalty".

Remission Requests

Remission requests are normally initiated by taxpayers or GST/HST registrants (including rebate claimants) either directly, or through a representative (including Members of Parliament). Requests may be made to:

(a) the Minister;

(b) the Deputy Minister;

(c) Headquarters functional divisions; (d) tax services offices;

(e) taxation centres; or

(f) the International Tax Services Office.

A remission request may also be initiated by a lax services office, taxation centres, the International Tax Office, or Headquarters functional divisions in cases when relief is warranted but is not otherwise available under the law.

Responsibility for the Remission Process

The Headquarters Remission Committee is responsible for reviewing remission reports and recommendations for both income tax and GST/HST cases, and for making further recommendations to the Assistant Deputy Minister, Policy and Legislation Branch, as necessary. The Income Tax Rulings and Interpretations Directorate (for income tax cases) or the GST/HST Rulings and Interpretations Directorate (for GST or FIST cases) provide reports with recommendations to the Committee.

Tax services offices are responsible for considering ail remission requests using the remission guidelines, whether the requests are received directly from taxpayers or GST/HST registrants, or from Headquarters. The offices are also responsible for preparing an initial recommendation and full report to Headquarters regarding each case. When remission requests do not originate in tax services offices, they will be reviewed by either the Income Tax Rulings and Interpretations Directorate, or the GST/HST Rulings and interpretations Directorate, as appropriate, with input sought from tax services offices when necessary.

When is Remission Appropriate?

A remission allows the government to provide relief to a person when the desired resuit cannot be otherwise achieved within the tax legislation, through assessing or other action. Generally, ail means available under the *Income Tax Act* or Part IX of the *Excise Tax Act* should first be exhausted, including objection and appeal, as well as the competent authority and mutual agreement procedures under tax conventions, before remission relief is considered.

"Taxpayer relief" provisions in both the *Income Tax Act* and Part IX of the *Excise Tax Act* allow the Department to exercise discretion in providing relief in certain circumstances. The following publications provide guidelines regarding fairness legislation for both income tax and GST/HST:

- Information Circular 07-l, “Taxpayer Relief Provisions”
- GST memorandum 16.3, “Cancellation or Waiver of Penalties and/or lnterest”
- GST memorandum 16.3.1, “Reduction of Penalty and interest in ‘Wash Transaction’ Situations”.

Normally, the CRA does not consider remission while a case is being reviewed through the objection or appeal process. However, if no objection or appeal has been filed, but it is evident that the requested relief is not available under the law, the CRA will not insist that the person use the objection or appeal process before submitting a remission request.

Remission Guidelines

The CRA has created remission guidelines that its staff can use when deciding whether to recommend a situation for remission. However, unlike information on the voluntary disclosures program published in Information Circular IC 00-1R2 and guidelines on the taxpayer relief provisions set out in IC 07-1, the remission guidelines have not been published in an information circular.

In the remission guidelines, the CRA notes the following characteristics that when present, may indicate that remission is appropriate under subsection 23(2) of the Financial Administration Act

(1) extreme hardship;

(2) incorrect action or advice on the part of CRA officials;

(3) financial setback coupled with extenuating factors;

(4) unintended results of the legislation.

Combined with the items listed above, other factors that the CRA officials will consider when deciding whether or not to recommend remission include: the taxpayer’s compliance history, credibility, age, and health.

Under the category of “extreme hardship”, listed above, the guidelines suggest that extreme hardship is indicated if the taxpayer’s annual family income for the year in which remission is requested, and each subsequent year is less than the Statistics Canada low-income cut-off in the area that the taxpayer resides. It is noted that extreme hardship may also apply to a corporation where a large group or community may be affected such as a company shutdown in a small community; however, it likely would not apply to payroll deductions or other amounts held in trust for the Crown.

In terms of the second item listed above, the guidelines note that “there may be cases where another federal government department or agency bears some responsibility for a person’s circumstances and may co-sponsor a remission”. if remission is requested under the category of incorrect advice or action by the CRA, the taxpayer has to show that the advice was incorrect at the time it was given; the taxpayer acted on the advice; the taxpayer believed that the person

giving the advice was acting in official capacity as a CRA official;; and there was another legal course of action available to the taxpayer that would have reduced the tax liability.

The guidelines explain that the third item that night warrant the recommendation of remission — financial setback coupled with extenuating factors, requires a significant financial setback in combination with at least one extenuating factor. The guidelines list three main extenuating factors: circumstances beyond a person's control; taxpayer error; and court decisions. It acknowledges that there may be other extenuating factors, but the key is that the factors be reasonable and relate to the remission being requested. Financial setback is described as being less severe than "extreme hardship", and the circumstances of the taxpayer will determine the significance of the setback. Similarly, other factors will determine if remission is warranted, such as the knowledge level of the taxpayer in situations where action has not been taken or an error has been made, and whether or not the CRA should have picked up on the error. The guidelines note that the CRA does not apply adverse court decisions retroactively, so this extenuating circumstance would rarely give rise to remission.

Remission could be recommended in situations where certain transactions give rise to results not intended by the legislation. Recommendations for remission in these circumstances would be subject to agreement by the Department of Finance.

Recommendations for remission are presented to the CRA's Headquarters Remission Committee. If remission s not granted, the CRA's Assistant Commissioner notifies the taxpayer or authorized representative. Where remission is granted, the order works its way through the Department of Justice, the Assistant Commissioner, the Commissioner, the Minister of Revenue, and then the Treasury Board, after which the remission order is published in the Canada Gazette Part II. Where remission is denied, the taxpayer may make an application to the Federal Court of Canada for judicial review. Under section 18.1 of the *Federal Courts Act*, the Court can only determine if the Minister's discretion was properly exercised. If the Court decides that it was not, the Court can refer the remission request back to the Minister for reconsideration.

PART IX - REVIEW OF RELEVANT CANADIAN LITERATURE ON TAX DISPUTE RESOLUTION AND TAX ADMINISTRATION AND ENFORCEMENT

Minister of Revenue, and then the Treasury Board, after which the remission order is published in the Canada Gazette Part II. Where remission is denied, the taxpayer may make an application to the Federal Court of Canada for judicial review. Under section 18.1 of the Federal Courts Act, the Court can only determine if the Minister's discretion was properly exercised. If the Court decides that it was not, the Court can refer the remission request back to the Minister for reconsideration.

1. Generally

- More about CRA can be learned from the CRA Internet Website or from the multitude of publications which CRA issues

- There are some excellent texts on tax dispute practice: 1) McMechan and Bourgard; 2) Innes, Chua and Bissell; 3) Tari; 4) Chodikoff and Horvath (ed) 5) Campbell

- *Federal Court Practice 2010 (*Saunders, Rennie, Gaston) (Carswell) deals with practice in both the Federal Court and the Federal Cour of Appeal ("**Federal Court Practice**")

- McCarthy Tétrault on Tax Disputes (bi-monthly publication from CCH) and Tax Litigation (Newsletter – Federated Press) are two newsletters devoted to tax dispute resolution

- Information about the Tax Court, Federal Court, the Federal Court of Appeal and the Supreme Court of Canada can be derived from their respective websites (see below)

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